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POLISH DEBT CRISIS

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE
COMMITTEE ON APPROPRIATIONS
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

SPECIAL HEARINGS

Congressional Witnesses
Department of Agriculture
Department of Defense
Department of State
Department of the Treasury

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POLISH DEBT CRISIS

TUESDAY, FEBRUARY 9, 1982

U.S. SENATE,
SUBCOMMITTEE ON FOREIGN OPERATIONS,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10 a.m., in room 1114, Everett McKinley Dirksen Senate Office Building, Hon. Robert W. Kasten, Jr. (chairman) presiding.

Present: Senator Kasten.

Also present: Senator Moynihan.

DEPARTMENTS OF AGRICULTURE, DEFENSE, STATE, AND TREASURY

OPENING STATEMENT OF SENATOR KASTEN

Senator KASTEN. The subcommittee will come to order.

This morning we will receive testimony from the Departments of Defense, State, Treasury, and Agriculture on the Polish debt crisis. Essentially we are going to discuss the U.S. Government's reponse to the Polish debt crisis.

We believe this hearing comes at a particularly appropriate time, in fact at a crucial time, in the continuing policy debate with reference to the U.S. response to the Polish debt question.

There are a number of perceptions that the American people now have with respect to this situation, none of them very favorable toward current administration policy.

The first perception is that we are bailing out the banks.

The second perception is that we are bailing out the military government of Poland.

The third perception is an extension of the second, in that the administration's soft line is having the effect of the United States, in the words of the Wall Street Journal, "slipping into tacit collaboration with martial law by making it easier for the Soviet bloc to finance repression * * *"

The fourth perception is that while we keep giving signals that we are willing to go to the brink on the Polish question, we again back away from it. Thus, gone is the perception that the administration will follow through and not damage its credibility.

QUESTIONS ADDRESSED TO POLISH SITUATION

There are a number of very serious questions which I would like to see addressed today in this hearing. Obviously the central question is should we or should we not declare Poland's debts in default, who would be hurt the most, and who would be helped by this action? Who is hurt or helped by the continuing soft policy that seems to have been developed by the Departments of State and Treasury in reaction to the current situation.

At this juncture it would seem to me that the course which is required is for the United States to declare Poland's debt in default. That action, I believe, is not only justified by the technical facts of the current situation, but such action was anticipated by the creditors when they rescheduled Poland's debt in April 1981.

It does not seem to me that such an action would be unusual under these circumstances, and, in fact, it is an action which we said we would take, we along with the other creditors, under the so-called tank clause of the 1981 rescheduling agreement.

Such an action, in the words of one American investment specialist, would put the economic burden of the satellite states squarely on the back of the Soviet Union and point up the bankruptcy of the Communist system by declaring bankrupt one of its units.

When the economic burden grows sufficiently heavy, the Soviet Union may become more accommodating, and together with the United States, may find it is in its self-interest to reduce drastically defense budgets neither can really afford.

While this subcommittee does not have jurisdiction over the greatest bulk of the guaranteed loans which have been made to Poland, those made by the Commodity Credit Corporation—CCC—we do have jurisdiction over the guarantees provided by the Agency for International Development and the Export-Import Bank.

More importantly, our jurisdiction covers numerous situations similar to Poland where the U.S. taxpayer may be called upon to pay under guarantees provided to lenders.

Thus, while most of these issues are particular to Poland, there are lessons that can be learned which affect a wider perspective.

HEARING FORMAT

The format for this morning's hearing will be as follows:

First of all, Dr. Fred Ikle will present testimony, followed by questions from the subcommittee. Then, as Dr. Ikle has a scheduling problem, he will be excused, and we will ask Mr. Hormats, Mr. Lyng, and Mr. Leland to come to the witness table as a panel, each individual presenting brief testimony, followed by questions and discussion from the subcomittee members.

We have also had a request from Senator Moynihan to appear before the subcommittee. He has a particular interest in this issue, and he may or may not be participating either on this side or that side of the microphone.

Let us begin with Dr. Fred Ikle, Under Secretary for Defense Policy.

Dr. Ikle.

DEPARTMENT OF DEFENSE

STATEMENT OF HON. FRED C. IKLE, UNDER SECRETARY OF DEFENSE FOR POLICY

EFFECT OF FLOW OF WESTERN CREDITS IN SOVIET BLOC ON NATIONAL SECURITY

Dr. IKLE. Mr. Chairman, you have invited me to address an issue of great strategic importance, how the flow of Western credits in the Soviet bloc affects our national security.

This question is now receiving a great deal of attention in the West. The attention, which was long overdue, is caused in part by the fact that some of the Soviet bloc debts are now hovering at the edge of default, especially, of course, as you mentioned, the Polish debts.

Mr. Chairman, I appreciate this opportunity to appear before you. I agree that the issue of default of Polish loans must be seen in a larger context.

How Western governments and bankers deal with these loans may be critical to the future flow of Western resources to the Soviet Union. And this flow, in turn, is vital for our security.

The administration has just presented to Congress a policy statement that bears on this context. Yesterday Secretary Weinberger submitted the defense report, which—in accordance with statutory requirement—not only presents the defense budget but also the administration's defense policy, coordinated within the NSC structure.. I shall distill from it a few interrelated points to establish the connection between our national security goals and the issue of Western credits to the Soviet economic sphere.

SOVIET MASSIVE MILITARY BUILDUP

First, even though the Soviet gross national product is only about 60 percent as large as that of the United States, the Soviet investment in arms and in other military assets is much larger, exceeding ours by 80 to 90 percent during the last 5 years.

This excess military investment keeps tilting the military balance in favor of the Soviet Union. It is this trend primarily that forces us to increase our defense budget.

Second, it was precisely during the period called detente, not during the cold war, that the Soviets embarked on and persisted in this massive military buildup. And this was also the period when East-West trade expanded and when the West gave increasingly accumulating credits to the Soviet economic system. By propping up the economies

of the Soviet empire with Western credits we made it easier for the Soviet Union to finance its military buildup.

Third, during this past period it was argued by the proponents of easy and expanding credits for the East that there would be political and security benefits from this largesse.

The expanding trade and credit flow would help thaw the vestiges of the cold war, it was said, and thus induce military restraint. Yet, during this period the Soviet military buildup accelerated and the Soviet military expansion spread into South Yemen, Indochina and Afghanistan, and on many other places.

CARROT THEORY

It was also argued that credits and technology transfers to the Soviet empire would be a "carrot" that they could use to exert some beneficial influence on Soviet behavior. This theory, too, is now torn to shreds by stubborn, contradictory facts.

Paradoxically, the carrot theory is being damaged precisely by those people in the West who want to extend more credit and expand East-West credit trade further. George Ball, for example, worries about the need to extend new credits and about financial stringency that would blight both West and East should the spigot be turned off.[1]

These arguments greatly overstate the costs to the West of discontinuing the subsidies to Communist governments. The sky will not fall on the West. A limited but significant peace, though, may fall on the East. The pain in the West would be quite tolerable. It would be confined mainly to those financial institutions and those traders who argued that we should extend the carrot to the East to induce good behavior, but who are now opposed to withdrawing this carrot when the behavior repeatedly is abominable.

Those ideologs who remain locked into the simple illusions of detente warn us that if the Western economic support for the Communist governments were discontinued, the Soviet leadership would go even further in strengthening its military power and simply starve its own people.

This view reveals a lack of understanding of the current strains and stresses in the Soviet economy. Without constant infusions of advanced technology capital from the West, the Soviet industrial base would experience a cumulative obsolescence which would also constrain the military sector. And the Soviet economic system cannot be reformed without liberalizing society as a whole. Thus, by furnishing aid to the Soviet Union, the West is unwittingly postponing this very liberalization that it seeks to foster.

When the illusions of detente still prevailed, many in the West argued that by offering technology and easy credit to the East we would be tying the Eastern bloc to the West. Now we discover that it is the West, or rather a segment of it, that feels bound to the East.

The Soviet Government, by controlling all of its purchasing agents, its banks and front organizations, is now able to manipulate powerful

[1] Washington Post. February 7, 1982, p. B-8.

institutions and influential individuals in the West. The purpose of this manipulation is to maintain a generous flow of resources from the West to the East.

The Alliance's threat to stop the flow was supposed to constrain Soviet policy. But those who made it their business to profit from the business of subsidizing the Soviet bloc have now turned their theory upside down. They argue that stopping the subsidies would threaten the West as a whole and not merely those who have special interests in continuing the subsidies regardless of Soviet behavior.

Mr. Chairman, it is always a mistake in policy to lose sight of the basic objectives.

Many of the objectives that have been mentioned in the press are of secondary importance, or irrelevant.

For example, it is not our objective to teach a lesson, whatever that means, to either the Polish or the Soviet Governments. We are not dealing here with a teacher-pupil relationship. Nor is it our objective to sound tough and hard any more than it is our objective to sound soft and sweet.

INTEREST ON POLISH LOANS

Also, it makes little difference for the security of the Alliance whether or not Western banks and governments receive the interest payments on the Polish loans. What matters more is whether the Soviet economic system will receive additional credits in the years to come.

The overriding objective for East-West economic policy is to improve the security of the Alliance, to reduce the danger of war, to enhance the prospects for genuine arms control. To this end we must let the inherent weakness of the Communist economic system take its course so that it will constrain the Soviet military buildup. This, Mr. Chairman, is the fundamental strategic interest of the Alliance in the issue before your committee.

Now as to the tactics in pursuit of this strategy, a number of technical details have to be carefully considered. Unless we foreclose options prematurely, however, we have time to work out the tactics. We are, after all, confronting a chronic condition, not a brief crisis, the chronic failure of the Communist economic system. We have time, therefore, to think our strategy through and can well afford to avoid precipitate steps.

The President's decision on the CCC's assumption of recent Polish interest payments reflects such a prudent approach.

As Mr. Meese said on television last Sunday, while it was decided not to exercise the default option at this time, we do deliberately retain it as a live option. That option, as you probably recall, Mr. Chairman, has long been discussed with our allies who in the past have agreed, as you mentioned in the introduction, that declaring default would be appropriate in circumstances such as Soviet or Polish Government repression of the Poles. A common front with our allies is, of course, of great importance and will enhance the security of the West.

But we must face the facts vigorously. It appears that the rolling over of bad loans is often accompanied by the rolling over of bad illusions.

Several years ago the assumption seems to have been widespread among bankers that the Soviets would not allow any COMECON members to default or even to reschedule because of their concern for their economic and political image.[2]

Today this illusion has been rolled over into a new one: that it is now the West and not Moscow that must prevent default to protect the Western banking system. So it is now argued by these rollover bankers that if they formally recognized what is patently the case—that some East European governments can no longer service their outstanding loans, much less new ones—the whole West European banking structure would come crashing down like a house of cards.

Mr. Chairman, the Western financial system may show certain weaknesses today, but it is not that weak.

Mr. Chairman, the Soviets have for years found it necessary to subsidize East European economies to help maintain their imperial control. This assistance competes with their military expenditures. Hence, we do not want to relieve the Soviets of this burden, particularly while they insist on maintaining their repression. There is allied agreement on this point, as reflected in the January 11 declaration of the NATO foreign ministers.

I imagine there is also agreement among the taxpayers throughout the Alliance that they do not want to be taxed for the Soviet military buildup twice: First, because the Soviet buildup necessitates an increase in allied defense budgets; and a second time, by having to subsidize bad old and new loans to the Soviet bloc, a transfusion that will facilitate the continued military buildup and might require still further military efforts by our Alliance.

Mr. Chairman, this concludes my opening remarks, and I will be pleased to answer your questions.

Senator KASTEN. First of all, I would like to thank you for your powerful and bold statement.

CONTROL OF SOVIET PURCHASING AGENTS

I would also like to follow up on one point that you raised. You said that by controlling its purchasing agents, its banks, and front organizations, the Soviet Union is now able to manipulate powerful institutions and influential individuals in the West. I think that is an overriding concern of the Congress, and the question is: Are those powerful institutions and individuals part of our own Government? In other words, are we seeing the State Department, the Treasury Department, and other groups now without options?

It seems to me that the economic and trade relationships with the Soviet Union and the Eastern European countries have hardly served our own best interests. The benefits of expanded trade with the West were intended to be dependent upon Soviet and Eastern European restraint with this so-called hoops of gold policy.

Now it seems to me that, first of all, we are getting locked in without

[2] Institutional Investor, July 1976, reports this assumption. In September 1981, Institutional Investor notes that lenders were joking feebly about the "leaky umbrella" of Soviet backing.

options. But more importantly, our threats to use the economic measures are diminished. Our threats no longer carry any credibility, as we say that we are going to cut off trade, or technology, or whatever it might be.

DECLARATION OF POLISH DEFAULT

Wouldn't a declaration of Polish default right now restore that missing credibility? Wouldn't it be simply doing what we said we would do, and what the Western creditors said they would do under the exceptional circumstances provision of the April agreement? Wouldn't that give teeth to this policy? You said it wasn't the idea to teach the Soviets a lesson or to teach the Polish government a lesson in your statement, but it would demonstrate our commitment and concern.

Dr. IKLE. Mr. Chairman, let me first address the first part of your question. What I was referring to were business entities in the West or steel exporters in Germany or computer exporters in France or fertilizer exporters in this country, what-have-you, who in dealing with the Soviet Union have to deal with entities that are totally controlled by the Soviet Government, that are responsive to the policital objectives of the Soviet Government, that obviously are in cooperation and under the monitoring of the KGB, and therefore they are confronting a large entity, the Soviet Union, that can orchestrate its business dealings to serve its larger purposes. Whereas in the West the business entities are in a free enterprise system more or less on their own even though they may get Government support, as is the case in Western Europe.

The continuation of favorable business transactions favorable to the Soviet Union can be manipulated, as I put it, or can be promoted by the Soviet Government in a way that it doles out profits and incentives contracts. It keeps contracts dangling in front of those companies that do not cooperate and gives more lucrative contracts to other companies that might be more cooperative and may even perhaps make a little push toward the political objectives that the Soviet Government favors. We have seen this process taking place to some extent in Western Europe.

It is that which I had in mind in my reference to manipulation and obviously not members of governments in the Alliance, much less here.

As to the second part of your question on default, let me make a more general statement here, and my colleagues in the Treasury Department and Agriculture should elaborate on the specifics regarding the financial aspects.

But obviously if you do talk of a threat, of a stick and carrot, it is important that we retain the credibility that we can carry out a threat or we can use a stick as well as a carrot. This is what I referred to. Otherwise, these instruments do not work.

There is some argumentation among business circles in Western Europe now and maybe among banks here as well, I do not know, that turn around this argumentation, as I mentioned in my testimony, namely, that they change what the initial premise is and present the case as if the leverage was now with the other side.

Specifically on the default question, I don't think there is much to add to what you said in your opening remarks. The option has, of course, been discussed with the allies last year and, as you said, we had an agreement reached in connection with the rescheduling last year of the Polish loans, that they could be called up under exceptional circumstances. The definition of exceptional circumstances, of course, does fit the present repression in Poland.

So the allies and we have a solid agreement, and I think it is therefore possible to avoid major differences among the allies which is an important objective, as Secretary Haig has properly emphasized recently.

I recall the discussions and considerations of the rescheduling last year. I think it was an agonizing decision. The credit rating of Poland was very low last year, and in the end the decision was made to go ahead with rescheduling and some new financing for agricultural exports because it was decided in the larger political context that we wouldn't want to deny to the progressive forces in Poland Western support, including U.S. support backed by American taxpayers.

I think that was a generous act, but in a sense an exception to prudent and cautious banking behavior. Today the reason for the exception with the reactionary development in Poland, of course, has gone. It is for that reason that the President decided, and as Mr. Meese and others indicated, that we keep open the option of default, and we do not want to go ahead with rescheduling.

TANK CLAUSE

Senator KASTEN. You pointed out in your answer that we have, in your opinion, exceptional circumstances in Poland at the present time. For the purpose of the record, that was the so-called tank clause, with the idea that tanks coming across the border would create the exceptional circumstances.

But in your opinion, we have exceptional circumstances by having over 5,000 people unaccounted for in detention camps. The exceptional circumstances, in your opinion, have in fact been met; is that correct?

Dr. IKLE. Clearly the situation is such in Poland with the martial law and the interference by the Soviet Union that has been referred to both by our allies and by this administration, by the President himself, that we do not, like last year, want to continue to provide Western support as we did last year to the Polish economy. Therefore, the decision was reached, indeed by the NATO allies as a whole, not to go ahead with rescheduling or new loans but to hold all this in abeyance.

Senator KASTEN. If the tanks came across the border would the loans be in default? In other words, those circumstances would clearly be even more exceptional than we have now. Would we have a stronger reaction on behalf of our government?

Dr. IKLE. The question of default is really a more narrow fiscal question, and I think the Treasury Department would be better qualified to address that.

DECLARATION OF DEFAULT

We must keep in mind of course that declaring default does not relieve the debtor of his obligations. It is a calling of the loan. There is in a sense, and I am not sure of the correct technical term, I am not a Treasury expert, a de facto default in that the interest payments have not come in. What specific technical steps you want to take, given that situation, you should ask the experts.

Senator KASTEN. Simply because they haven't paid it, we could call the loans or call them in default. The other way to declare default is based on the April agreement and the so-called tank clause. Do you feel that this administration's position would have been stronger, that we would have declared default, as the April agreement said we could, if the tanks, in fact, had come across the border?

Dr. IKLE. I don't see a difference there. Of course, the question that we have to keep in mind is the future developments in Poland, and they may be affected differently if the tanks had come across the border than given the present situation.

To the extent that we want to encourage a return to the progressive situation that existed in Poland last year with the democratic forces, perhaps the door is wider opened to that future than if the tanks had come across the border. So from that point of view you may have a difference in regard to the future prognosis for Poland.

But as far as the monetary conditions, and the fiscal conditions for default are concerned, that of course has to do with the failure of paying the interest.

BURNS CABLE

Senator KASTEN. You discussed this briefly in your testimony. We have heard dire predictions about the impact of default on our Alliance. How do you assess these predictions? It is my understanding the Burns cable was one of a number of cables that came from our ambassadors throughout Europe setting out what the impact of a default would be. The Burns cable has been picked up by a number of papers, including the Wall Street Journal. What would the impact of default be on our Alliance?

Dr. IKLE. Well, as you mentioned, Mr. Chairman, we have an agreement within the Alliance that was reached last year in the process of the rescheduling of the loans. Given that we have an agreement, you might say we should have the condition for unity to proceed in accordance with that agreement.

As to the fiscal implications of default, formal default as distinct from the factor that the interest payments are not being paid, that again you will get different expert opinion from the banking community and you will get the expert opinion from the Treasury Department on that.

My concern, or I should say our concern, looking at this from the national security point of view, is simply that we keep our larger objective in mind. The objective is not to make it easier for the Soviet war machine to receive Western subsidies. The importance, therefore, is not to transfer additional credits and other resource transfers to the Soviet economy. That is the target on which we must keep our eye.

APRIL AGREEMENT

Senator KASTEN. You are saying then, in answer to my question, that we should have and we do have Western unity on the default because of our April agreement?

Dr. IKLE. I think the April agreement was, as the word says, an agreement among the allies on how one might proceed in certain circumstances. That always gives you a leg up if you want to establish unity.

Senator KASTEN. So they should expect us to do what we said we would do, or that as a group the allies would do what we said we would do in April. Exceptional circumstances have been reached, and if a default were called we should have unity on it because we have agreed to it before? Is that essentially it?

Dr. IKLE. All I can say is that we have a basis for taking positions that were agreed to. Now what particular position we want to take, as the President decided, we are keeping open the option, and there are questions of timing and technical procedures on which others should testify.

NATURAL GAS PIPELINE

Senator KASTEN. We have been talking about the bigger picture with regard to the Soviet military buildup, but also I would like to discuss briefly the natural gas pipeline. It seems to me that this, at least, is one of the specific issues of concern. It is going to provide an unprecedented flow of Western hard currency into the Soviet Union as soon as it is completed.

It will help them develop resources they could not develop as quickly without Western technology and know-how. At the same time, it will increase West European dependence in the way that all of us are concerned about, especially psychological dependence on the Soviet Union in the case of the natural gas.

A declaration of default would affect both the willingness and the ability of our allies, especially West Germany, to go ahead with this project. It seems to me that this might be the least controversial way of stopping or at least delaying the pipeline for 2 or 3 years.

First, do you think it is in our best interests to block or to delay the pipeline? And, second, wouldn't a default declaration be a step in the right direction to delay that pipeline?

Dr. IKLE. It is the President's position, it is our position, the U.S. position, that the pipeline preferably should not be built, and if something has to be built that it shouldn't have these large proportions, and it should be much more constrained. We made that position for many months to our allies. Some of our allies see the situation differently and do want to go ahead with the pipeline.

I think the concern is that it would create, not only in the 1990's, a cash flow for the Soviet Union which, if the Soviet Union is still embarked on the present course, would help its further military buildup. That concern is real, but there is also the concern of the dependence. Indeed, the dependence is already most vividly illustrated by the very fact that business concerns that hope to get exports to get the pipeline built are the most ardent lobbyists in Europe for going through the project.

It precisely illustrates what I was referring to earlier about this manipulation in that the Soviet Government as a whole in controlling its banks, its purchasing agents, and its contract writers can manipulate interest rates and credits to shift the margin of profit here or there, to middlemen who would be active in the West to promote the project, to corporations, to labor unions, and what-have-you. The process of manipulation is fully underway and is fully demonstrated right now before even the pipeline gets started.

Once the gas starts flowing and additional elements of the pipe ends up being added, I am afraid we must expect from what we have seen so far that it would get worse.

Senator KASTEN. Wouldn't a declaration of default be a step in the right direction toward blocking that pipeline or at least slowing it down for a couple of years?

Dr. IKLE. Again here you ought to talk to experts in international banking. As a layman in that area, or rather hearing others say that default could, if it had further repercussions, depending on how it plays itself out, make it more difficult for the credits arrangements that have been negotiated for the pipeline to survive. Whether that is the case or not, I am not expert to testify on that.

Senator KASTEN. In conclusion, besides the credibility aspect that I mentioned and the pipeline issue, what would be the primary purpose of a default declaration? Wouldn't it aggravate the financial strains already apparent in the Soviet economy, first of all? And wouldn't it make it more difficult for the Soviets to continue their extraordinary military pace?

A declaration of default would have a ripple effect all through the Eastern bloc countries, and wouldn't that make it more difficult for the Soviets to continue this unprecedented military buildup?

Dr. IKLE. Whether these consequences would flow and in what timeframe again is a question for financial experts to answer. All I could say here, from point of your defense interests, the national security interest, is if these consequences indeed were predictably to flow from default, then our national security interest would argue in favor of default. But whether they would flow or not is a financial question.

Senator KASTEN. Thank you very much for your testimony.

SUBMITTED QUESTIONS

Other Senators may have some questions for the record. We will provide those questions to you, and hopefully you could provide us with answers for the record.

Thank you very much for your testimony.

Dr. IKLE. I would be pleased to do so, Mr. Chairman.

Thank you very much.

[The following questions were not asked at the hearing but were submitted for response for the record:]

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QUESTIONS SUBMITTED BY SENATOR INOUYE

Question. It has been reported that the Pentagon was alone in its opposition to the administration's decision to pay $72 million to U.S. banks that were owed money by Poland rather than allowing Poland to go into default. Is this an accurate report?

Why is the Defense Department opposed to efforts to avoid declaring Poland in default? Is it your judgment that Poland should be formally declared to be in default?

Answer. The Pentagon was not consulted in advance on the matter of Commodity Credit Corporation guaranteed loans. It is our understanding that the U.S. Government has the obligation under guarantee provisions of a loan to pay off creditors in the event they cannot collect. The Department of Defense is not normally consulted under this procedure.

Department of Defense supports the decision of the President not to formally declare Poland in default at the present time. We do believe, however, that all Eastern bloc countries should be required to make good on their obligations. We believe that the Soviet Union bears specific responsibility on behalf of its Eastern bloc clients. It may be necessary in the future to declare Poland in default as a measure of forcing the Soviet Union to accept responsibility for its role in Poland. The Department of Defense is especially concerned that Western credits not be used to shore up the martial law regime in Poland or to subsidize the Soviet military buildup.

Question. It has been suggested that the primary argument for supporting a declaration of default is that such a declaration would cause the Soviet Union to shift funds away from its military budget in order to pay Poland's debt. Do you regard this as a valid argument?

What factual basis do you have to support this conclusion?

Answer. The following evidence supports the assumption that in order to pay the Polish debt, Soviet hard currency assets will have to be shifted away from its military budget. Currently, these hard currency resources are severely strained to meet domestic consumption and economic requirements of COMECON—whose member nations are facing serious financial troubles. Soviet hard currency subsidies to her satellites amounted to $6 billion in 1981. Added to this burden, continuing crop failures have led to high Soviet grain imports totaling $7 billion in 1981 or roughly double the level of 2 years ago. This combination of financial problems has resulted in a substantial depletion of Soviet hard currency reserves—indeed the cash balances in the West of all COMECON nations may have plunged by 75 percent to $2 billion. In order to cope with this tight financial situation, Moscow has been selling gold, oil, and diamonds to the West to obtain this much needed hard currency. While it is unlikely that Soviet bankruptcy will result, continued borrowing and new austerity measures—cutting domestic consumption and slowing military spending—will likely result from this dilemma.

Question. Is it not possible that U.S. declaration of default by Poland would so threaten the economies of the Soviet Union and its satellites that the Soviet Union might tighten its hold on Poland and other countries in Eastern Europe? Could it not in fact cause the Soviet Union to increase its military budget?

Answer. Soviet political and economic hegemony over the Eastern bloc is already very evident and deliberate. Further consolidation of Soviet dominance over the Eastern bloc cannot be enhanced by a U.S. declaration of default. The avoidance of the question of the bankruptcy of Eastern Europe economies hardly encourages liberalization of these regimes despite massive Western lending. The Soviet Union acts with impunity over Eastern Europe which has been subsidized largely by Western lending practices. We believe termination of credits will cause pressure to decrease the military budget as competition increases between military and civilian sectors—capital equipment and materials.

Question. Apart from a direct reduction in its military expenditures, what other actions could the Soviet Union take to enhance its ability to finance Poland's debt?

Answer. Increased Soviet hard currency earnings can be derived from sales of gold, diamonds, and oil. In addition, hard currency earnings could result from reductions in oil and gas exports to Eastern Europe. Last year, the COMECON nations were told by the Soviets that oil deliveries would be cut by 10 percent to free this resource for the much needed hard currency sales to the West. In 1980, Soviet earnings from oil and gas exports amounted to $17 billion or nearly two-thirds of the total Soviet foreign currency.

Question. Could a default by Poland so threaten the Soviet Union that it might embark on a strategy to achieve autarky—that is, complete economic independence—for the Communist bloc countries? Might the declaration of default provoke the Soviet Union into drastic measures such as seizure of Iran's oil fields?

Answer. Complete economic independence in the long run would not solve the chronic problems of these centrally planned economies. Soviets have tried to be as autarkic as possible and the strategy has failed. Indeed, the strategy over the past 10 years to acquire Western technology explicitly recognizes the limits of the economic independence. Throughout its history, the Soviet Union has turned to the West for the basic necessities of life—such as food—when its own economic system has failed. It is highly unlikely that the financial consequences and frank military risks would provoke the Soviet Union into such a risky and unproductive venture as the seizure of Iran's oilfields.

Question. If the United States were to declare Poland in default, what could be done to contain economic destabilization? Is it not possible that economic chaos would spread throughout Eastern Europe and then into the Western economies?

Answer. Economic destabilization is currently a problem in Eastern Europe without a formal declaration of Polish default. The Soviet Union is experiencing a severe financial bind primarily through a lack of hard currency. Added to this is the serious financial troubles of the member COMECON nations—Rumania, itself on the verge of bankruptcy, Czechoslovakia, and East Germany. The West through commercial transactions, cannot modify the economic instability of the Soviet bloc. In fact, we may now be faced with the culmination of a grand strategy by the Soviets to receive goods from the West and delay payment on these goods indefinitely. In this way, the Soviets have leverage over our internal affairs as well as our relations with our allies.

The likelihood of economic chaos spreading to Western economies as a result of Polish default is highly improbable, large though the loans are—$27 billion, $6 billion of which is guaranteed by Western governments. If Poland were to default altogether, Deutsche Bank would still profit, Bank Fur Gemeinwirtschaft—FRG's largest Polish creditor—would still be in comfortable surplus on its capital and resources and the first quarter (only) earnings of Bank of America—Poland's largest American bank creditor—would drop by about one-seventh.

Question. On February 1, 1982, the New York Times quoted Richard N. Perle, Assistant Secretary of Defense for International Security Affairs, on the subject of Polish default. He said, "I don't think anyone can predict accurately the consequences."

Are you confident that you can predict the consequences of Polish default?

Are you confident that a U.S. declaration of default by Poland will not compel the Soviet Union to take measures which are even more harmful to Poland, and to U.S. interests, than their present actions in Poland?

Answer. Political and economic predictions rely heavily on multiple factors and timing, thus the consequences of a Polish default are somewhat difficult to characterize. However, on the political side of the argument that if Western economic support for the Communist governments were discontinued, Soviet leadership would further strengthen its military capability and simply starve its people overlooks a basic need of the Soviet system—Western technology—to stave off economic obsolescence. Further, in light of the Polish crisis, continued repression on a blocwide basis is a risky venture at best.

On the economic side, we view the consequences of a Polish default as containable by the Western economic system. While the amounts are large in absolute terms, they are small in relative size to international finance markets. For example, the total amount of Polish debt to U.S. banks is less than many individual U.S. corporations also facing financial difficulties.

Question. I understand that the Secretary of Defense is opposed to the construction of a natural gas pipeline from the Soviet Union to Western Europe, because in his view it would not only make Western Europe dependent on Moscow for vital energy supplies but would also earn the Soviet Union $10 billion a year in hard currency that could be spent on Western technology having military applications.

In the final analysis, is that not why you would favor a declaration of default by Poland—because it would ultimately foreclose Soviet access to Western credits needed for construction of the pipeline?

Answer. Desirability of the Polish debt default must be decided on its merits. We take the position that the West should not subsidize the failure of totalitarian dictatorships which cannot manage their own economies. It is true also that we oppose the West Siberian pipeline which will provide hard currency earnings of some $8 billion annually over the next 25 years. These funds will be used to shore up the Soviet military industrial system in part by acquisition of advanced Western technology. We think that current events in Poland amply demonstrate the dangers of dependence on the Soviet Union for vital raw materials such as energy.

DEPARTMENT OF STATE

STATEMENT OF HON. ROBERT D. HORMATS, ASSISTANT SECRETARY OF STATE

COMMODITY CREDIT CORPORATION LEGAL OBLIGATIONS

Senator KASTEN. If we could ask now for Secretary Hormats, Secretary Lyng and Secretary Leland to come forward.

Bob, why don't you start. We will go through a series of brief statements. I understand that Mr. Lyng has a brief statement, as well. We will start with you, and then we will have questions afterward.

Secretary Hormats.

Mr. HORMATS. Thank you, Mr. Chairman.

I very much welcome the opportunity to appear before the subcommittee to discuss our policy toward Poland and, in particular, the Polish debt situation.

I will comment specifically on an issue which has a direct bearing on that policy, the method adopted by the CCC to meet its legal obligations to those U.S. banks which have repayments due from Poland on U.S. Government guaranteed credits extended to Poland in 1979, 1980, and 1981 for purchases of agricultural commodities.

Mr. Lyng will provide a more detailed discussion of CCC policy and regulations.

POLISH DEBT FACTSHEET

I would also like to submit for the record a factsheet on Polish debt which gives some additional detailed information on that subject.

[The factsheet follows:]

Fact Sheet on Polish Debt

-- Poland has an external hard currency debt of approximately $26 billion; government and government-guaranteed debt is some $17 billion; private unguaranteed debt is some $9 billion.

-- Of this amount, roughly $20 billion is due to sixteen western countries.

-- Polish debt to the United States totals some $3.15 billion, which is 14% of the total $26 billion.

The breakdown of this figure is:

Non-guaranteed loans from private creditors (Primarily commercial banks)	1.3
Direct credits and guarantees by Commodity Credit Corporation	1.6
Export-Import Bank Loan	.244
AID Loan	.006

-- Governments of sixteen western countries including U.S., U.K., France, West Germany, Japan, Canada, Switzerland, the Netherlands, signed a multilateral agreement in April 1981 to reschedule 90 percent of the principal and interest falling due from May 1981 to December 1981. The U.S. share of this was $380 million. The official rescheduling totalled $2.3 billion.

-- Repayment terms provided for four years grace and four years repayment, the latter commencing in 1986.

-- These terms are generally comparable to those of other countries who have found it necessary to reschedule their debts.

-- In response to the Polish repression in December, the official creditors recently agreed to hold negotiations with the Poles on their 1982 debt service in abeyance pending a normalization of the situation. They also decided that in any event they would continue to adhere to their long-standing understanding that they will not discuss the 1982 debt until Poland signs a rescheduling agreement on its 1981 debt with the commercial banks.

-- The commercial banks of the sixteen western countries have been negotiating a debt rescheduling agreement with Poland.

-- The terms of this agreement as we understand them -- providing for rescheduling 95 percent of principal only, $2.3 billion -- appear to be comparable to those provided by Poland's official creditors.

-- It is also our understanding that the government of Poland must pay all interest due to the commmercial banks prior to signing of that agreement.

-- We have heard that this amount is now on the order of $250 million. We are in no position to comment one way or another as to whether the Poles will meet this payment.

-- Total debt outstanding to all banks is around $15-16 billion; about $14 1/2 billion was recorded as of June 1981 for those banks in the reporting system of the Bank for International Settlements. However, much of this would be guaranteed by creditor governments. After allowance for guarantees, the commercial bank debt is thought to be around $9 billion.

-- The precise amount of banks' guarantee-adjusted exposure in individual countries is reported regularly only for U.S. and U.K. banks (exposure in Poland of $1.3 billion and $1.0 billion, respectively, as of mid-1981). Around 60 U.S. banks account for the $1.3 billion, most of which report amounts equal to less than 5 percent of their capital, broadly defined.

-- Continental banks have a relatively greater exposure in Poland. The degree of exposure varies among individual banks. Some figures have appeared in the press, but we cannot attest to their authenticity.

-- As for 1982 maturities, we estimate that Poland's debt service obligations to official and private creditors for 1982 total roughly $10.4 billion -- $6.8 billion in principal, $2.8 billion in interest, and $0.8 billion interest due on the rescheduled 1981 debt.

Poland

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981 (estimate)
	(billions of U.S. $)									
Non-Communist										
a)Exports	1.8	2.5	3.9	4.1	4.4	4.9	5.5	6.3	7.4	5.6
b)Imports	2.0	4.0	6.0	7.4	7.5	7.1	7.5	8.8	8.8	6.5
c)Trade balance	-0.2	-1.5	-2.1	-3.3	-3.1	-2.2	-2.0	-2.5	-1.4	-0.9
Gross Debt	1.6	2.8	4.6	8.0	11.5	14.0	17.8	21.1	25.0	26.0
Principal Repayment	0.2	0.3	0.5	0.7	1.2	2.0	2.9	3.6	5.6	6.4
Interest	0.1	0.2	0.4	0.5	0.7	0.9	1.5	2.2	2.4	3.3
Debt Service (as % of exports)	15	19	23	30	42	59	79	92	108	173

U.S. AND ALLIED POLICY

Mr. HORMATS. Let me begin by sketching out U.S. and allied policy and actions since the imposition of martial law in Poland.

We and our allies have agreed that we will accept nothing less on the part of the Polish government than lifting martial law, releasing the detainees, and restoring the dialog with Solidarity and the church. We will keep sustained pressure on Poland until these conditions are met.

The January 11 Special Ministerial Meeting on Poland, and subsequent meetings of the North Atlantic Council, with the attendance of senior political and economic officials from capitals, have led to measures by allied nations to increase pressure on the Poles and the Soviets.

We and our allies are considering additional measures. Among the measures already taken multilaterally against Poland are cessation of new commercial credits, restriction of credits for food exports, except humanitarian assistance, and suspension of consideration of 1982 debt rescheduling negotiations. In addition, the United States has unilaterally suspended Polish airline landing rights and fishing rights.

The Western Alliance is in full agreement that the Soviet Union bears a heavy responsibility for, and is deeply involved in, the repressive policies of the Polish regime.

The allies agree that pressure must be put on the Soviets to bring about a restoration of the reform and renewal process in Poland.

ECONOMIC PRESSURE ON U.S.S.R.

The United States has taken a number of specific steps to exert pressure on the U.S.S.R. of which you are all aware. Our allies have also announced actions against the Soviets. For example, Italy has declared a "pause for reflection" in its negotiations to buy Soviet gas, many European countries have cancelled official high-level exchanges and visits and are implementing their exchange agreements on a restricted basis.

In addition, as you may know, the British a couple of days ago announced in Parliament a number of additional measures which they were taking.

The allies are also considering additional measures. For example, the European community is considering increasing the interest rate charged for export credits to the U.S.S.R. and restricting imports of Soviet goods.

We and our allies are consulting closely on what we can do to bring further economic pressure to bear on the Polish and Soviet governments.

The military crackdown in Poland and related events demonstrate the weakness of the Communist system that the Soviets have imposed on much of Eastern Europe.

The Soviet Union is also attempting to turn its failure in Poland into a foreign policy victory by dividing the Western Alliance. We and Europe are attempting to insure that this doesn't happen.

Our objective is to maintain and indeed strengthen allied unity through common support of sustained pressure on the Polish and Soviet governments to end repression in Poland.

It is vital at this crucial point in history that a firmly allied West make clear to Warsaw and to Moscow that we will continue such pressure and refuse any return to business as usual as long as violations of internationally recognized human rights continue in Poland.

POLISH DEBT OBLIGATIONS

Poland, as you know, has massive debt obligations to Western governments and private banks which total something on the order of $26 billion in all. It owes the U.S. Government directly about $740 million, most for CCC direct credits. In addition, Poland owes U.S. banks about $800 million for credits extended under CCC guarantee programs and about $1.3 billion in unguaranteed credits.

Our objective is to insist that Poland repay its debt. At this point it is our assessment that this is the best way of keeping pressure on the Polish government and indirectly on the Soviet Government. Our allies share this view. And we and they have agreed to suspend consideration of talks on rescheduling Poland's 1982 debt obligations.

This allows the official Western creditors to pursue the collection of 1982 Polish debts. In fact, Poland is making partial payment to Western creditors while no new credits are going to Poland. Thus, there is a net financial flow from Poland to the West.

With no new Western credits going to Poland, and with Poland being pressed to repay its debt, the Soviets are having to transfer significant amounts of resources to Poland. In other words, what we have today is a reversal of the situation which was indicated earlier, and in fact as a result of Western pressure on Poland there is a net resource drain from Poland to the West; the Soviets, as a result, are having to put additional sums of money into Poland to shore up its economy.

DECLARATION OF DEFAULT ON POLISH DEBTS

It has been suggested that we might exert even more pressure on Poland and the Soviet Union by declaring official Polish debts in default. Clearly, declaring official default is an option that can be used if circumstances warrant.

However, our current assessment is that our officially declaring Poland in default might be used by the Polish government as an excuse to relieve itself of its obligation to make any repayments.

In addition, it would be a sanction that would be difficult to reverse if the Polish situation improved. And our allies have expressed strong concern about the impact of a formal declaration of Polish debt on their banks and on the international financial system, a concern shared by U.S. financial officials.

Moreover, if we were to unilaterally declare default, the possibility exists of others being repaid before us or instead of us.

Finally, if the objective is to deny the Poles due credits, that has already been achieved without formal default being declared.

CCC HONORING OF DEBTS TO U.S. BANKS

The administration decided that CCC should honor its obligations to those U.S. banks which have claims against CCC guaranteed credits. Since there is a great deal of misunderstanding about the implications of this decision, I want to emphasize several points.

First, the CCC proposal in no way relieves Poland of its obligation to pay these debts. The only difference is that the Polish government would owe the money to the U.S. Government instead of U.S. banks—and we will press hard to collect.

Second, it is not a bailout of the banks. The U.S. Government guaranteed these credits. They are due and unpaid, and we are obligated to honor our guarantees.

Third, it does not prevent the banks from declaring Poland in default. The banks are owed nonguaranteed credits and could declare default if these are not repaid. They have not done so.

Fourth, it is not a rescheduling for the Poles. There is no extension of maturities or change in terms.

Finally, there has been a great tendency to characterize approaches to this issue in terms of hard and soft. I prefer to look at it in terms of what produces the greatest pressure on Poland and on the Soviet Union, as well as insures the best chance of loan repayment.

It is a broadly shared conclusion by the highest levels of this Government and by the highest levels of all allied governments that pressing for repayment rather than declaring formal default best serves these objectives.

I thank you, Mr. Chairman.

Senator KASTEN. Bob, thank you.

Secretary Leland.

DEPARTMENT OF THE TREASURY

STATEMENT OF HON. MARC E. LELAND, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS

BASIC CONCERNS ON POLISH SITUATION

Mr. LELAND. Thank you, Mr. Chairman.

Thank you for giving me the opportunity to discuss this Polish debt situation with you and members of the committee.

I understand that you have two basic concerns: One, whether Poland should be declared in default as a means to exert pressure on the Polish regime; and, two, you are concerned about the Government paying the CCC's guarantees of commercial loans to Poland.

As Bob just said, the President has decided that maximum pressure can be put on Poland by insisting on repayment of their debt, both that portion which we did not reschedule last year, and that which falls due this year, and not by declaring the Poles in default at this time.

I want to emphasize this point strongly because there has been so much confusion and misinformation on the issue.

Private banks are not now lending any money to the Polish government. Poland, however, is making some payments, though by no means all that is due, both to the official creditors and commercial banks in the West. Thus, we have a situation of money flowing from the East to the West as opposed to the situation which we had a year ago when banks and governments were putting money into Poland.

By adhering to this policy of pressuring the Poles for repayment, while not putting any new money into Poland, we will perpetuate this situation. This hurts the Polish regime because this net outflow means they are giving up more than they are getting. And, as I noted above, they are getting no new credit now.

DISADVANTAGES OF DECLARING POLAND IN DEFAULT

Would declaring a default bring more pressure on the Poles or on the Soviets than that which now exists? I don't think so. In fact, declaring a default now could make things easier for the Polish regime. This sounds like an anomaly, but it is not.

If the United States were to declare a default against the Polish government, as some have argued, Poland could use that as an excuse to keep from paying even those small amounts which it is presently paying. They might be free to use their scarce foreign exchange either to pay other creditors, who might not declare default, or make new purchases. In this case, of course, the U.S. Government would be free to seek to attach Polish assets, but there are virtually none. And even if

there were any, they would be difficult to attach for reasons of sovereign immunity.

Thus, analyzing the situation this way, the Government, like private banks, has determined that there is more chance of getting paid if we do not declare Poland in default but insist that they pay their indebtedness.

It has been suggested that a declaration of default against the Poles could force the Soviets to pay the Polish obligation. This does not appear to be the case. It would in fact reduce the pressure that currently exists for the Soviet Union to help Poland in whatever way it can so that the Poles can continue to make some payments.

It has been alleged that any payments by the CCC to the commercial banks would in effect be bailing out the banks and letting the Poles off the hook. This simply is not the case.

The United States has an obligation to honor its guarantees on the loans which commercial banks made to Poland. This we are doing. When that process is complete, the guaranteed portion of Poland's debt will be owed to the U.S. Government rather than the commercial banks.

I can assure you we will do everything possible to collect that debt. I can also assure you that this transfer will not in anyway undermine or weaken the ability of the commercial banks to call a default on their many unguaranteed private loans to Poland which are not being paid on time. That they have not done so and show no intention at this time of doing so denotes, as I have said, that they came to the same conclusion as we have—by an independent process—that it is better to collect some money than none.

By insisting that this be done, we preserve to the maximum extent possible our separate but similar interests in being repaid. At the same time, the U.S. Government is maintaining its objective of placing the maximum possible pressure on the Polish regime. We believe this policy is the most effective approach we can take.

I would like to add a couple of comments on Under Secretary of Defense Ikle's statement, with which I totally agree, and I would like to just accentuate a few of the useful points that he made.

He pointed out, for example, that the proponents of easy and expanding credits for the East failed to consider adequately the long-term implications of these credits. Fortunately, many of these same proponents now appear to be learning their lesson, albeit late, but they are now learning it.

SHORT-TERM CREDITS TO SOVIET UNION

Private credits to the Soviet Union, aside from short-term trade credits, have virtually dried up. As far as this administration is concerned, we are providing no aid whatsoever to the Soviet Union and have, as Mr. Hormats mentioned, along with our allies, determined that no further aid will be provided to Poland in the current circumstances.

Dr. Ikle also pointed out the danger of technological transfers to the Soviets because Western technology is a lifeline for advancing their economic and military regime.

When this administration came into office, we recognized this immediately and took steps to tighten our controls on the exports of high technology goods to the Soviet Union.

After the imposition of martial law in Poland, we took further steps to restrict Soviet access to oil and gas technology. We have been meeting with our allies and to some degree have reached agreement on the need to tighten further the controls on the export of high technology equipment to the Soviets.

Dr. Ikle also made the point that the decision to have the CCC meet its guarantees is consistent with this approach. As I said, we believe it is. It helps to continue the pressure on the Poles to pay their debt, and indirectly pressures the Soviets.

Finally, as Dr. Ikle said, default always remains an option. I would fully agree with him that we must rid ourselves of certain illusions about the Soviet Union and its economy, and I feel this hearing and all we are doing will help to bring to everyone's attention the credits that have been going over the years and the fact that this has been, in our view and in this administration's view, a mistaken policy. The Soviet Union would be in far more trouble had there never been any credits going to the East.

WEAKNESS OF SOVIET ECONOMY

The Soviet Union still has a weak economy, even with all our credits. The nonmarket mechanisms which run the Soviet economy and which guide many of the other Eastern European economies will fail in the end. Even the Soviets know this since the most productive parts of their economy are those in which the marketplace reigns, such as the private agricultural sector, what exists of it.

The weaknesses in the Soviet economic system are clearly beginning to show. We know it, they know it, and our allies know it. And most important of all, and I think this is the point for this hearing, the market knows it.

Whether you declare a default in Poland or whether you don't declare a default in Poland isn't the issue. The issue is, What is the financial situation in Poland? It owes an enormous debt. The Soviet Union owes an enormous debt. The market sees this, and it is our job in the West to continue pressuring these countries so that the maximum amount possible of this debt be paid. We intend to continue doing this.

As we said, default always remains an option at such time as we think it might increase our leverage.

Thank you.

Senator KASTEN. Thank you.

Secretary Lyng.

DEPARTMENT OF AGRICULTURE

STATEMENT OF HON. RICHARD E. LYNG, DEPUTY SECRETARY OF AGRICULTURE

RESTORATION OF CCC REALIZED LOSSES

Mr. LYNG. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before you. I will not repeat the things that have been discussed by the previous witnesses, but I would like to talk very briefly about the need to restore the CCC's realized losses and the relationship between this legislation which is pending before the Congress and the action of the Polish debt situation.

Let me say at the outset that there is no connection between these two events.

The need for restoring the realized losses of the CCC is directly associated with the operation of commodity programs during the crop years 1980 and 1981. These losses totaled approximately $5 billion. They result primarily from costs associated with CCC price support purchases, such as the dairy program, disaster and deficiency payments to producers, emergency feed payment programs and the expenses incurred in operating the farmer-owned grain reserve program.

Under law the CCC finances these operations initially by borrowing funds from the Treasury. These Treasury loans are repaid with interest when the necessary funds are appropriated by the Congress. Restoring these losses would enable CCC to repay this debt to the Treasury and thus help restore our CCC line of credit with the Treasury within the $20 billion overall limit prescribed by law.

NO REALIZED LOSSES INCURRED BY CCC

Recent publicity has associated the question of CCC losses with issues related to Polish export credit. It should be clearly understood that no realized losses have been incurred by the CCC with respect to the making or guaranteeing of export credit to Poland.

Therefore, none of the $5 billion we are now requesting is needed for such a purpose. All of the Polish debt or credit extended by the CCC or acquired by the Corporation under its guarantee programs is being maintained as accounts receivable. There are no current losses resulting from this debt.

The need to reimburse CCC for its losses is urgent. The record level of production of the 1981 crops and the unprecedented demand for commodity loans, together with income support for deficiency payments, have contributed to the near depletion of the $20 billion in borrowing authority.

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The reimbursement for losses that we are requesting will allow the Corporation to continue to operate the price and income support programs farmers depend upon. If the CCC losses are not reimbursed immediately it will be necessary to suspend all loan and payment operations until cash receipts are of sufficient volume to make the resumption of operations feasible.

The CCC deals with millions of farmers and utilizes the services of thousands of banks, processors, carriers, exporters, handlers, warehousemen and others. Without funds to carry out CCC operations the day-to-day business dealings of many segments of the economy will be adversely affected.

Mr. Chairman, that completes my prepared statement and I will be glad to participate with my colleagues in attempting to answer any questions.

Senator KASTEN. I am pleased that you pointed out to the subcommittee the fact that the CCC has something to do with the dairy program. I don't know, that must have just been some kind of a——

Mr. LYNG. I thought you would be aware of that, Mr. Chairman. [Laughter.]

RELATIONSHIP OF POLISH DEBT TO CCC REALIZED LOSSES

Senator KASTEN. On page 2 you said, "Therefore, none of the $5 billion we are requesting is needed for such a purpose of guaranteeing export credit to Poland." Does that mean that you would not object to an amendment on this $5 billion appropriation bill, if it could be adopted before we go on recess, that would simply say that none of these CCC funds may be made available for the purpose of either paying interest or principal on any of the Polish debt?

Mr. LYNG. We would have to object to a provision that said that, because it would in fact force us to fail to live up to our commitments on our guaranteed loans, and thus would jeopardize our guaranteed loan program, which is very important to agricultural exports from the United States.

Senator KASTEN. Well, you can't have it both ways. You can say either part of the $5 billion is needed or part of the dollars that are now in the CCC pool is needed for the purpose of bailing out Poland or it is not needed for the purpose of bailing out Poland.

You said that none of the funds you are requesting is needed for such a purpose. If that is the case, why would you object to an amendment if it would not slow up the process?

Mr. LYNG. I think you misunderstood me, Mr. Chairman. I said that we did not need these funds to reimburse CCC for realized losses caused by the Polish program. A prohibition that would have the effect of prohibiting the CCC from making payments in the event that the Poles failed to pay or any other country failed to pay would be a different thing.

Senator KASTEN. Then some of the funds are needed for this purpose. Let's look at it another way. Are the CCC payments, which are going to the banks for the Polish debt, coming from funds that otherwise would be going to American farmers?

Mr. LYNG. We have not failed to make any payments or loans to American farmers because of the payments that have gone to these banks. So it is not an either/or situation.

Senator KASTEN. If the payments were not going to the banks wouldn't they be going to the American farmers?

Mr. LYNG. No.

Senator KASTEN. These are fungible funds, isn't that right?

Mr. LYNG. Up to this point, Mr. Chairman, we have not run out of our authority to borrow funds. If we were to run out, then it could be argued, I suppose, that to the extent that we made payments on these guaranteed loans, that that was the case, but that has not happened, and we would certainly hope that that situation wouldn't evolve.

DEFINITION OF DEFAULT

Senator KASTEN. Don't your regulations require a notice of default, a claim for loss and certain documents to be filed with the CCC before the Government is obligated to pay either the interest or the principal on these debts?

Mr. LYNG. I think that there is a requirement. I don't have the regulations in front of me, and I would be happy to submit those for the record, but I believe that it calls for a notification of nonpayment or default; yes.

Senator KASTEN. If the answer is, "Yes," then how is it you made an offer to repurchase these debts without the default being called? Aren't you in violation of the regulations?

Mr. LYNG. We are confident that we are not in violation of the regulations and that the regulations are sufficiently broad. We were in no way making payments without being notified by banks that they had not received payment.

Senator KASTEN. But in your opinion, it does require an official notice of default before the Government is obligated to pay; is that correct?

Mr. LYNG. Mr. Chairman, there seems to be a great deal of difference in definitions of the word "default." I know that we must be notified that the bank has not received payment. To the extent it requires a formal default notification, I don't think it does.

TANK CLAUSE

Senator KASTEN. Bob, let me see if we can go through the clarification of the agreement signed by Poland's Western creditors when its 1981 debts were rescheduled in April of last year.

First of all, do I understand correctly that the so-called tank clause was a substitution for conditionality of the rescheduling, and that the clause calls for default in the event of exceptional circumstances?

Mr. HORMATS. My impression is, Mr. Chairman, that what the tank clause or the exceptional circumstances clause does do is say that if it is invoked, if a decision is made to invoke it, then the 1981 rescheduling becomes null and void and all the debts which were rescheduled come due. It does not speak directly to the issue of default. That would be a

separate decision which would have to be made by the individual creditors.

POTENTIAL INVOCATION OF TANK CLAUSE

Senator KASTEN. Do you agree that the declaration of martial law in Poland is an exceptional circumstance?

Mr. HORMATS. Oh, yes. I think virtually all of the allies have agreed that technically the exceptional circumstances clause could be invoked if they determined that they were agreed to invoke it. This was discussed among the allies, and it was felt that while the circumstances for invoking it in fact do exist, the question was whether it was wise to do so and whether that would be a better way of putting pressure on Poland than continuing to force them to pay their debts.

Senator KASTEN. In your testimony you talked about a firm allied West and a unified response.

Mr. HORMATS. Yes.

Senator KASTEN. Shouldn't the allies expect, based on what took place in April, and the fact that we do have exceptional circumstances, that in fact we would declare those debts in default? Shouldn't they expect that and shouldn't we have an allied West, as Fred Ikle was discussing?

Mr. HORMATS. I think we certainly have an allied West. For that reason we discussed this at considerable length. My colleague, Mr. Meissner, who participated in the debt reschedulings, Secretary Leland and I have had discussions with our allies on this. The general conclusion among all the allies was yes, technically the exceptional circumstances clause could be used if desired, but they felt that it was not the best way of continuing to put the pressure on the Poles.

Senator KASTEN. At this time.

Mr. HORMATS. Yes, sir.

Senator KASTEN. Normally everyone ends with "at this time" in these discussions.

Mr. HORMATS. Right.

IMPACT OF POTENTIAL DEFAULT

Senator KASTEN. One of the arguments that State and Treasury have continued to make with respect to the current U.S. policy vis-a-vis default, and you both made it in different ways in your statements, is that such a declaration would cause financial havoc in the rest of Eastern Europe, which in turn would create havoc upon Western financial institutions and governments.

The inference is, and to me it is incredible—and Mr. Leland talked about the problems that we have gotten ourselves into with this credit—but the inference is that we must continue to prop up the military government of Poland and the rest of Eastern Europe in order not to cause damage to our own financial institutions or to the financial institutions of our allies. It seems to me that that is just an incredible argument.

Mr. LELAND. Mr. Chairman, I don't think I made that point, because it is not one I would want to make. What I said is that the Polish debt situation is creating havoc in Eastern Europe. Whether you say the

Poles are in default, or whether you don't say they are in default, doesn't change that circumstance.

The fact, as Secretary Hormats said, that you have got $26 billion owed by Poland whether you call it a default or not. It is a fact that the debt situations of the other countries in Eastern Europe have been affected.

So the issue is not one of not declaring default because you are afraid of some havoc that it is going to cause in Eastern Europe or, from my standpoint at least, that it is going to cause in Western Europe or in the United States.

The main issue is, how do you maintain maximum pressure? It is no different than when you have a debtor who could clearly be called into bankruptcy because he isn't paying his debts. But you decide, as the creditor, that you are going to maintain much more leverage and pressure on him by insisting that the debtor service these debts even if you do not receive all the payments which are due.

The interesting part is that the Poles are continuing to make payments. Private banks, for example, have debts which they could call into default at any time because they haven't received full payment. The banks have determined that they don't want to call a default because they feel that maximum pressure on the Poles to repay comes from the threat that they will do so. It comes from the fact that the banks say the Poles must continue to pay, and it has worked. The Poles have managed to make substantial repayments on their 1981 interest due to the banks.

If the bankers felt differently, they would operate differently. They would have no reason not to declare default if they felt they had a better chance of collecting by so doing.

Senator KASTEN. In your opinion, the reason we are not calling the debt in default has nothing to do with the fact that such a declaration might cause financial havoc in banking circles in the West?

Mr. LELAND. I do not feel that that is the reason for not declaring default. If I felt that it would create more pressure on the Poles and more difficulties on the Soviet Union to declare default at this time we ought to do so.

EXTENSION OF CREDIT TO EASTERN EUROPE

Senator KASTEN. It is important that you just added the Poles and the Soviet Union. One of the problems with earlier testimony is that we have cut off credit to the Poles, and our allies have cut off credit to the Poles; but our allies have not cut off credit to the Soviet Union and to other Eastern European countries. So we can talk about Poland, but the effort here is all of Eastern Europe, all the Soviet satellites.

In the case of our allies, they are continuing with guarantees to the Soviet Union and to others, particularly Germany. So it is overall, not just Poland.

Mr. LELAND. The credits that are going to the Soviet Union, or other Eastern European countries for that matter, are short-term trade credits. There hasn't been a syndicated loan for some time for the Soviet Union.

You can also look at the Eastern European debt situation. Can you imagine a private banker going out now and extending loans to them? He would only do it with his own governments guarantees. Without government guarantees, private banks are not giving credit, and that is an important point.

ADVANTAGES OF AVOIDING DEFAULT

Mr. HORMATS. May I add one point to follow up your question, Mr. Chairman?

Senator KASTEN. Yes.

Mr. HORMATS. We certainly want to continue to put increased pressure on Eastern Europe and on the Soviet Union. The basis of our argument here is to add pressure on the East and not to alleviate pressure on the East.

What we have done with respect to Poland is in effect force an outflow, a net outflow of hard currency from Poland to the West. That is really the thrust of what we are doing and what our allies are doing.

This does two things: One, it raises the price of repression for the government in Warsaw; two, it means that any additional flow of resources that the Poles are going to get above and beyond what they earn through their sales of coal and such things to the West has to come from one place, the Soviet Union. And we know for a fact that the Soviets are having to put a substantial amount of resources into Poland to help deal with the major problems they have and to sustain what is now a declining Polish economy.

Senator KASTEN. I am encouraged by what you both have just said because in previous discussions on this issue a number of people from banking circles and representatives of some of our allies have brought up the financial havoc point first.

They say not only would it force an unraveling of our banking system, but it would have a tremendous effect on the West German banking system. They will even go further and say not only do we have trouble then with the Eastern bloc countries with all the loans we have made there, but in Brazil and in Mexico it would start to unravel, as well, and that we would see problems worldwide.

You both reject that thesis, and you both feel that that has nothing to do with the present posture vis-a-vis our unwillingness to declare the Polish debt in default; is that correct?

Mr. HORMATS. The central focus of our policy is to put maximum pressure on Poland, and therefore on the Soviets. There is a concern among our allies that how we deal with this issue could have an effect on the Western banking system by causing a considerable amount of uncertainty that could have a weakening effect.

Senator KASTEN. Don't back away from what you said before. It is either one way or the other.

Mr. HORMATS. The major objective is what I had described earlier. I am simply saying that there is also a concern that it could have an effect of creating uncertainty in the banking system.

U.S. POLICY OBJECTIVES

Senator KASTEN. But it is a concern from the point of view of the State Department?

Mr. HORMATS. The key concern for the State Department is the point I made to you earlier.

Senator KASTEN. And you would also agree with Ambassador Burns and others who say that if, in fact, the debt is declared in default it would not have this tremendously disruptive effect that would ripple through the whole financial community?

Mr. HORMATS. I think it would be a manageable impact, but there would be an impact on some countries. I want to give you the most accurate version possible, and from all the conversations we have had, it is clear there would be some impact.

The main objective of our policy is the pressure on Poland.

Senator KASTEN. And that is the President's decision?

Mr. LELAND. The President's decision, Mr. Chairman, is in keeping with what we and the private bankers have determined is the best way of maintaining maximum pressure on the Poles. I think Assistant Secretary Hormats and I would agree that if we felt that maximum pressure would be applied by taking another action—default—that would be the policy we would follow, and the Western banking system could withstand that.

It is also a fact that the policy decision to maintain maximum pressure coincides with the argument that a default could create problems for the Western financial system; but that is not the basis of the decision. The basis of the decision is maximum pressure, and if maximum pressure could be exerted by another means we should do it, regardless.

CROSS-DEFAULT PROVISIONS

Senator KASTEN. Bob, in your testimony you mentioned that a default declaration might result in other creditors getting paid first, you being pushed to the back of the line.

Wouldn't that be a violation of the cross-default clause in the debt rescheduling agreement? It seems to me it would be unlikely, because of the cross-default clause, that everyone would get paid.

Mr. HORMATS. Well, banks have the option to use or not use a cross-default clause. Some may, in fact, decide they want to use it. Others may think they have a better chance of getting repaid by not declaring default.

PAYMENT UNDER GUARANTEED LOANS

Senator KASTEN. I would like to get some clarification of the decision-making regarding the CCC payments and process; second, the decision-making process which led to the determination that $71.3 million should be paid under the guarantees of loans to Poland.

Now, under the contracts between the CCC and the banks involved, what is the language? I would assume, Bob, you can respond to that. What is the language describing situations where the CCC would pay under the guarantees?

Mr. LYNG. In essence it says that if a payment is missed, we guarantee that we will make that payment for 100 percent of the principal and for accrued interest at the rate of 6 percent per annum.

Senator KASTEN. And that has nothing to do with default? It simply says if a payment is missed?

Mr. LYNG. Well, the word "default" is a common word that I think would be used if you failed to make a payment on an automobile or a home.

Senator KASTEN. The word "default" is included in the language?

Mr. LYNG. There's no formal definition in the agreement of "default." It simply says that the bank will notify the CCC, submit evidence, as I recall, that the sale was actually made, and that with the proper documentation we would make the payment.

Senator KASTEN. I would like to start with the title of the regulation. The title is "Guaranteeing Against Defaults by Foreign Banks Under CCC Export." The word "defaults" is in the title of the regulation.

STATUS OF POLISH DEBT

The current supplemental appropriation bill before the Congress for the CCC is described as necessary to pay off net realized losses. In the category of net realized losses there are a number of items that fit in. Polish debt is not in the category of net realized losses, but, rather, Polish debt is listed as a contingent liability.

What action or trigger could cause the Polish debt to be listed as a realized loss rather than as a contingent liability?

Mr. LYNG. As long as the debt has not come due, the fact that we have in effect cosigned the note—we guaranteed it—means that we have a contingent liability for the total amount of that debt. It could move into a different category. There really could be three categories: First, a contingent liability; second, an accounts receivable, which would be the case after we had made a payment, and we had not been repaid by the Polish government; and, the third would be when we decided that this debt was not really an asset that we should look forward to ever collecting, and we would write it off, at which time it would become a realized loss.

That action has not been taken. The Polish government had a pretty good record of payments with the CCC from 1964 until March of last year. Surely today it doesn't. The prospect doesn't look very good, but the fact is that the CCC at this point has not written off those amounts due. We still carry them as receivables and have notified the Polish government that we expect them to pay.

Senator KASTEN. You have not written them off, and they continue to be contingent liabilities, and they are not at the present time net realized losses. Is that correct?

Mr. LYNG. That is correct.

Senator KASTEN. They are not at the present time net realized losses, yet the supplemental appropriation bill that is before us is described as necessary to pay off net realized losses.

Mr. LYNG. These were losses that were incurred in totally different areas, Mr. Chairman. I tried to enumerate some of those. The CCC, based on the years 1980 and 1981, suffered losses of $5 billion not related to the Polish debt and we are asking that they be restored.

Senator KASTEN. Let me do it another way. When are you going to decide that these are net realized losses? We are in for $71 million now. You've got a total of $576 million—$876 million—through 1984. You are going month by month by month. Are these continuing to be contingent liabilities?

Mr. LYNG. Those have not yet become due. We certainly couldn't write those off. Those that have come due and that we have paid are currently accounts receivable. We haven't paid the $71 million yet. I think we paid $488,000 of that $71 million. Last calendar year we did make payments of, I think, $158 million and we failed to receive payments from the Polish government of an additional quantity of direct loans that we had made.

But it would be improper, it seems to me, to write off the entire $1.5 billion that is owed or guaranteed directly or through guarantees from the Polish government to the CCC.

Senator KASTEN. Another related point which needs clarifying with respect to the CCC action is whether or not decisions have been made which affect funds due in the future or if the decision before us today deals only with the $71 million which is due in January.

Now are you telling us that there is going to be an interagency decisionmaking process each month when a payment is due and unpaid?

Mr. LYNG. It will be done under the procedures that have been established on nearly a daily basis as these notes become due.

We really don't have much choice if we are going to live up to the guarantee of the U.S. Government. These guarantees were made in 1978, 1979, and 1980 based upon what was determined by the then-board of the CCC to be valid export sales and of value to the United States.

Senator KASTEN. Mark, at your press conference Friday you answered a question on whether or not a declaration of default would stop credit from going to the Soviet Union. And you answered that question just plain, "No."

Are you really suggesting that a declaration of default on Poland's debts would not have an effect on the ability of the Soviet Union to secure hard currency financing from the West?

Mr. LELAND. What I am suggesting is that right now the way to exert maximum pressure on the Poles is to push them to fulfill their obligations to whatever extent they possibly can. Insofar as there is any pressure on the Soviets to help them pay their debt, it probably is stronger when they think the amount needed to keep the process alive is a few hundred million dollars each time than if a default is called and, say, for 1982, $10 billion is due.

As Bob Hormats and I have said, credits are not going to the East. I basically agree with you, Mr. Chairman. If we saw credits such as syndicated loans going to the Soviet Union, and we felt a default could affect them, then I think it would be a step we should consider.

What is keeping credit from going to the Soviet Union and to the East in general is the Polish and Eastern European debt situation, not the legal issue of whether or not you call a default. It is the overall debt situation that is stopping the flow of credit.

If you were a private banker and looked at the situation in Eastern Europe would you make a loan to them now regardless of what we do?

Senator KASTEN. In your statement on Friday you also indicated that a declaration of default remains an option, and Assistant Secretary Hormats has said the same thing today, an option to be used at such a time as the administration sees fit. What specific event or what kind of circumstances do you believe would cause the administration to change its current policy and declare such a default?

Mr. LELAND. I wouldn't want to speculate on every possible circumstance that might have us declare default, but one that would is if that step would present a better method of getting paid.

If the Poles, for example, did not make any payments, and the flow of funds from East to West stopped, then there might be no reason not to declare a default. The issue will continue to come up, and we have already considered it to some degree in connection with the 1982 debt in general and whether or not to reschedule that debt, which puts pressure on them.

For instance, a decision was made that we wouldn't even discuss the 1982 rescheduling with the Poles until they paid what the banks insisted on receiving before concluding their 1981 rescheduling. Based upon that, the Poles have continued to pay.

If the Poles stopped paying, essentially declaring a moratorium, that in effect would be the default.

Senator KASTEN. Let me just try to change the direction here a little bit. It is my understanding that in the next couple of weeks there will be a special delegation that will go to work with our allies on this particular question. Is that also your understanding?

Mr. LELAND. We have been in constant contact and negotiation with our allies on the whole issue, and that will continue.

Senator KASTEN. It is my understanding there is going to be a high-level group that may include one or both of you to work with our allies specifically on this issue and, that we will, in particular, try to negotiate the machinery, equipment, and terms having to do with the Soviet natural gas pipeline. Is that your understanding?

Mr. LELAND. How we deal with Eastern Europe, regarding debt as well as the political situation in Poland, which Bob can refer to better, is the issue which I think we have decided. We have had several high-level delegations. I was over there at Christmas discussing it, as was Bob Hormats, and Larry Eagleburger. There was another meeting which Bob just got back from.

We will continue having these meetings to see how we can maintain maximum pressure on the Soviet Union on all of these issues. That is correct.

NATO MINISTERIAL MEETING

Senator KASTEN. In the process of working with our allies, aren't we in the process of encouraging them, for example, to halt the reexports of certain kinds of machinery and equipment for the pipeline? Aren't we quietly or maybe not so quietly using the possibility of default as a stick, in other words, saying you work with us and halt the shipments, halt the reexports and thereby slow down that pipeline for 24 or 36 months and if you don't do that, we may call the Polish debt in default? Bob?

Mr. HORMATS. May I answer first, the general issue relates to the question of the NATO ministerial meeting. There was a section in that communique, paragraph 15, which specifically related to undercutting, which is to say that we have been working with the allies to try to prevent anything which would undermine the effectiveness of the sanctions we have taken on high technology goods, energy goods, et cetera.

There are major differences in interpretations, how one interprets the question of undercutting. We've had some very sensitive discussions with them at the last NATO meeting, and at a number of bilateral discussions. I think that, to convey to you the nature of those discussions, it would be better to have a closed hearing. But we have been working very directly on the question of undercutting.

Senator KASTEN. And there is going to be a high-level meeting within the next 2 weeks?

Mr. HORMATS. So far as I know, there is no formal meeting planned. We have had many bilateral discussions with the key countries involved in this issue, and I think that is probably a better way of dealing with this.

I don't rule out a high-level meeting, but none is planned. The objective is the same in terms of dealing with the issues.

NEGOTIATIONS WITH ALLIES

Senator KASTEN. The point I am trying to make is, isn't it true that in these discussions, as we seek to put increased pressure on our allies on these reexports and, in particular, for the pipeline, aren't we using as a stick or a threat the possibility of declaring the Polish loans in default? That is the case, is it not? This is one of the options that we have remaining. That is why you answered the question with "at this time," or, as Mark said, "at this time we don't find it in our best interest."

Mr. HORMATS. We have made it a major point not to try to threaten the allies in order to get them to come along on the things that we want. We have been trying to develop a common understanding of the objectives that we both should be seeking and to try to work on that basis.

We have had a number, as I say, of very sensitive discussions on this issue, and I think they have not been discussions where we have threatened to do X if they don't do Y. They have been really by nature of trying to figure out what is our common objective, and how do we most effectively get there.

I think the best thing would be to convey that to you in private.

Senator KASTEN. I think there's a sense in the Congress and in America that too many of these negotiations and discussions, et cetera, have been going on in private.

What I am suggesting here is that you cannot have it both ways. You are saying, both of you, that default on the debt would not work, and at the same time you are suggesting in conferences with our allies that that is our trump card. However, we do not want to play that one right now because we want to try, if we can, to slow down reexports, particularly from Germany, on the oil pipeline. If we are successful in delaying the oil pipeline, and, therefore, putting the banks which are financing that pipeline in further jeopardy because they have got to get that hard currency, if that is put off 2 more years those banks are going to be even more worried because it is pipeline money.

The first gas that comes through will begin to repay those banks, and they are worried about it right now. If we delay that pipeline for 2 years, they are going to be more worried about it. If we delay for 3 years, they are going to be even more worried about it.

But aren't we using default as the trump card, at the same time you are telling us here that default wouldn't work?

Mr. LELAND. No, we're not using it. It simply isn't that big a threat. I think what Dr. Ikle said was perfectly correct. The Western financial system can withstand the situation whether or not you call Poland in default. What the Western financial system has to withstand is the fact that Poland owes $26 billion, and the prospects of it paying it in the near future don't seem very great. That is what it has to withstand.

I don't think actually declaring default is a threat or a trump card.

Mr. HORMATS. We have not used this as a threat against our allies to get them to do other things that we want. We are pursuing that through separate channels. A key objective is to avoid a threat.

Senator KASTEN. The objective isn't to avoid a threat? The whole objective is to continue pressure on the Soviet Union and the Soviet bloc countries?

Mr. HORMATS. That is the main objective. But the overall objective of what we are trying to do with our allies, as I indicated before, is to put maximum unified pressure on the Warsaw government and on the government in Moscow.

If we were to go through a period of open threats, that is going to be counterproductive in getting the allies to go along with us in achieving our objectives. The reason I am reluctant to discuss some of these things in open hearings is that it is wrong to deal with the allies by discussing sensitive issues publicly. That is not, clearly, the way to negotiate.

The third question relates to the pipeline. It is clear that there are a number of European governments which are strongly committed to that pipeline. If there were a default there is no assurance at all that that in itself would delay the pipeline, largely because much of the pipeline is financed by government credits or government guaranteed credits. There is an option open to a number of Europeans, if they really want

to pursue the pipeline—and even if there were a Polish default which somehow affected credit markets—to get at that through government credits, government-guaranteed credits.

Senator KASTEN. I think there's a possibility that that was what West Germany would do, but the fact is that any default or disruption would certainly make the whole issue of credits and financing on the pipeline, for the wheat exports and for other material and equipment more difficult.

A default would clearly make financing the pipeline more difficult.

Mr. HORMATS. It would probably cause difficulties with respect to private financing.

Senator KASTEN. It would absolutely cause difficulties with respect to private financing.

Mr. LELAND. The difficulties are there, Mr. Chairman.

Mr. HORMATS. The difficulties are there already because of the problem of credit in Eastern Europe. The difficulties are there because the Poles have a debt of $26 billion. Other East European countries have debt problems. The German Democratic Republic has major debt problems as well as Romania and other East European countries.

The problem is that the Communist system in Eastern Europe is beginning to falter. These countries have built up very large debts which they are unable, in many cases, to repay. And that is causing serious doubts about lending either to Eastern Europe or to the Soviet Union. That is the situation at the moment.

There are no syndicated loans that we are able to identify going to the Soviet Union today.

Senator KASTEN. There are short-term credits, but not long and medium terms.

Mr. HORMATS. It's not because of "we"; it's because of the way they have run their economies.

Senator KASTEN. Well, on that issue, Marc, you suggested that one of the reasons we are doing this is because we have a realistic belief that somehow Poland is going to be able to continue to repay us. It is my understanding that as of right now the Poles have had to reschedule their 10-percent share of rescheduled direct loans, their 10-percent share of rescheduled guaranteed loans, and now the January $71 million payment.

Do you realistically expect that further payments are going to be made and, if so, on what basis and how much? Look at the money trickling in and the tremendous debt that is there. I think it just can't possibly be realistic to believe that they are going to repay that.

Mr. LELAND. As I said in my statement, I agree with you, Mr. Chairman. I think we both have exactly the same objective. I think it is perfectly true that the Poles are not paying the entire amount or anywhere near the entire amount that was not rescheduled in 1981 and is now due.

No one would argue with that. As for the question of when and how they are going to repay it, as you very well put it, it is problematical. It does not change the fact, however, that they are making some pay-

ments. They want the banks to reschedule the 1981 debt. The banks said they won't reschedule it until the interest is paid in full.

Now after the December 13 declaration of martial law, the banks were still owed some $350 million. That amount has been substantially reduced as money has flowed from the East to the West, but in nowhere near the amounts the banks would like to get. I can't think of a way to get more from them. If declaring a default was a way of getting more money, if there was some asset that could be attached, then that would be the policy we should follow.

The issue is not whether or not all the money is coming. The Poles are still feeling pressures and, they want to show they are still making every effort to pay. As long as those payments keep coming in, that leverage is working.

If no further payments come in, then that is when you reexamine the whole situation. Under this policy, however, the payments are still flowing.

Senator KASTEN. I know there are some payments that are flowing, but you do not realistically expect that the Polish debt, based on the present circumstances, is going to be repaid?

Mr. LELAND. I would not want to speculate about the long term. There are all kinds of ways and reasons for the Poles to repay. In the short term you are perfectly correct. They won't be abe to fully pay regardless of what you do. The question is how we get the most out of them, not how we get everything now.

Senator KASTEN. It seems to me that is the problem so many of us in Congress have. The question is not how do we get the most or how do we get the debt to be repaid. We are not going to get the debt repaid. What we are trying to do is demonstrate our concern about the repressive government in Poland and the direction in which the Soviet Union and the Soviet satellites are taking it.

If we are concerned about the trickle-out of a few dollars and that is why we are doing what we are doing, we have got our emphasis wrong. The money involved is used to demonstrate our concern about the overall situation that we have today and for the Polish people.

Mr. LELAND. The two issues are connected. Regarding expressing our concern, I think that is what all these meetings have been about. Regarding cutting off all official credit to the Poles, essentially all credit has been cut off. In the beginning, for example, the Europeans were going to continue to provide agricultural credit. They determined later they would stop after we had had our discussions.

Now the only thing that is going to Poland is humanitarian aid. To get the message of our disapproval of what is going on in Poland one need only read the Secretary of State's speech at the CSCE. It's clear that the issue is getting more out of Poland. There is a benefit to us not just in getting repaid but in putting pressure on the Poles to repay these funds.

If we get money from them, it will not be available for them to use for other purposes. I think that is the basic issue. That is the message we are trying to send them.

Mr. HORMATS. Let me just add to that because I strongly agree with what Marc was saying. I think, Mr. Chairman, the fundamental objective that you outlined in the beginning of this hearing is one that we totally share—that what we are trying to do with respect to our bilateral and our multilateral policy is to demonstrate quite clearly both to Moscow and to Warsaw that: One, we find the oppression abhorrent; two, that we know that the Soviets are involved; and, three, this is going to be a very costly repression for both countries.

And what has been done through unilateral and multilateral action is to engender a gradual increase in pressure from the other countries.

No new credits are going to Poland for manufactured goods. No credits are going for food other than humanitarian food, which goes through CARE or CRS. In addition, we have suspended consideration of debt rescheduling, so everyone is free to press hard for repayment of debt owed in 1982.

All this makes the economic cost of repression extremely high. The only place they can get resource transfers is from the U.S.S.R. Spare parts and the raw materials that the Poles need to run their economy are not available on credit from the West. The Poles are having to cut back on energy. Coal exports from Poland to the Soviet Union and to East Germany are being reduced dramatically because of the lack of spare parts for equipment.

The cost is mounting. The costs are mounting very rapidly. One can't predict that this is going to lead to a liberalization overnight, but what it means is the longer the repression lasts, the bigger the cost buildup to both Moscow and Warsaw. That is really what we're after—and this is part of that strategy—maximum pressure. We share totally the objective you have outlined.

Senator KASTEN. I feel that present action is less than maximum pressure, and that the maximum pressure would be default. That is where we disagree.

Mr. HORMATS. If there were defaults then you would find the Poles would probably say: "All right, the pressure in effect for us to repay is off for those who declared the default." That is one of the issues here. The best chance of putting the maximum pressure to obtain a reflow of currency from Poland to the West is by continuing to press them to pay their debts.

Now they don't pay as much as we would like, clearly, but there is a net outflow. There is a net outflow, and it is a high cost for an economy as weak as the Polish economy.

Senator KASTEN. What is international law with regard to a country going into default? It is my understanding that it is not clear. We are making assumptions that a country going into default would be like an individual going into bankrupty, that somehow these debts might never be collected.

On the other hand, that seems very unrealistic, if not impossible, from the point of view of a country. As you understand it, what is the international law regarding a country going into default. Isn't it likely that those obligations would in fact continue?

Mr. LELAND. So far as we can determine, no country has ever been declared in default for that very reason. The point is that when you have a bankruptcy situation you take all of the assets of the individual and then apply them to pay his debts. He is then freed after that.

In this case, the case of a country, it's not a situation of taking all of its assets, because you can't. So the declaring of default does not free them of the obligation to pay the entire amount. They have that obligation either way.

When a default is declared and they owe an amount of $10 or $11 billion, it is totally impossible for them to pay—the resources aren't there. The question then is whether they are then in a position to say that, when they can finally pay us we'll hear from them again.

We had a situation with China for years where they owed money, and went on trading. The money just kept on being owed for a long period of time but no payments were coming in on it. The main issue is, how do you get them to make any payments on their obligation? As Bob just said, any payments they make to us or anybody else on previous debts are payments that they cannot use to buy other things. We want them to make those payments.

Once the default is declared, will they decide to keep paying $200, $300, $400 million, or will they say, since we are in default and owe $10 billion, we're not going to make any dent in that by paying $400 million, and then simply stop paying.

If you declared a default, they couldn't get any more credits. Well, they are not getting any more credits anyway.

Senator KASTEN. In your statement you said something that is different, if I understood your answer to my question. In your statement, on page 2, you say if declaring a default could make things easier, if the U.S. Government were to declare a default against the Polish government, Poland in essence would be absolved from paying even those small amounts which they are now paying.

Now you just answered the question, it seems to me, differently from that.

Mr. LELAND. I'm glad you brought that up. They would not be legally absolved, and I want to correct any misimpression about that.

What I am saying is that their payment obligations would then be so large that it would be much more difficult to maintain pressure on them to come up with any amount.

Senator KASTEN. But would not in fact the Soviet Union, one way or another, have to come in and offset that debt?

Mr. LELAND. If I thought they would have to, I would certainly be in favor of doing it.

Senator KASTEN. You think they would not have to?

Mr. LELAND. They didn't guarantee the debt. I don't know how you get them to make payments. If I thought that, I would definitely agree with you.

Senator KASTEN. I understand they did not specifically guarantee the debt, but you understand my question is that in one way or the other those dollars are going to have to be replaced. The idea is, as Dr. Ikle

and, I assume, you would agree—and we all understand the route that we go through by subsidizing or guaranteeing loans to Eastern European countries—the Soviet Union is in a different financial position.

There seems to be no argument on those questions, but if we take that step all the way back, we assume that at one point the Soviet Union is going to have to shore up the economies of these governments.

Mr. HORMATS. There are two ways. They are, for certain reasons internal to the way COMECON countries work, providing some hard currency, but mostly it's what we call nonconvertible rubles, which means credits so Poland can buy Soviet goods. The pressure is on them to continue to provide that sort of assistance.

Whether or not the Soviets will directly transfer money to any country so it can pay back Western banks—the so-called umbrella theory—is in our judgment highly unlikely.

Senator KASTEN. We are not talking about transferring money. We are talking about the ability of running those particular economies to keep minimal civil unrest. The problem that they have right now would, I believe, be exacerbated if we declared that debt in default, and you would have even more of an emergency situation in trying to run those economies.

Marc doesn't agree with me.

Mr. LELAND. Well, it all goes back to the same issue, Senator. Given the Soviet financial difficulties and the mess their economy is in, they are not going to come up with the $10 billion to pay the Polish debt. Therefore, if we can get them to come up with any amount to continue to try to keep the debt alive, that is a pressure which may motivate them to try to come up with some resources.

The concept that they are going to come up with the entire amount at this particular time does not seem to be very realistic.

Senator KASTEN. Under current law it appears that the executive branch—and this law is in question—but from your opinion at least at this time, it appears as if the executive branch has the authority to pay out of the U.S. Treasury hundreds of millions of dollars against Federal guarantees of foreign loans without taking legal recourse to collect the foreign loan.

Under current law the executive branch can agree to forgo hundreds of millions of dollars in repayments due from loans of foreign governments. It appears that both actions have been taken in the case of Poland without formal notification to Congress and, as far as I can determine, without the knowledge of Congress. If it was not for the flap that occurred within the administration on this last $71 million, maybe Congress wouldn't know now.

Would you have any objection to changing the law to require prior notification to Congress before such actions are taken?

Mr. LELAND. I would have to comment on the basic statement of fact. I don't think the issue here is that we are forgoing the payment of this debt. We guaranteed an obligation. We are paying off on the guarantee.

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We will pursue the collection of the obligation to the extent of our guarantee. Part of the debt is unguaranteed, part of the interest is not guaranteed. We will pursue the collection of the debt to the extent of our guarantee. It is now our debt, and we will pursue the payment of it.

As all three of us have said, there is no discussion of rescheduling that debt. We will pursue getting it repaid, and the basic issue is how do you best pursue getting it repaid? Rescheduling of official debt is a much more technical and complicated issue, be it in the Sudan or elsewhere. It is something that the executive branch has to be concerned with.

The basic question is, How do you get the debt repaid? And we usually do it altogether—all the creditor nations get together and determine how we are best going to get this debt repaid. As we said, dealing with governments is not the same as dealing with individuals, because you don't have a pool of assets that you can immediately seize and then release them from bankruptcy.

Senator KASTEN. You mentioned the Sudan. In the case of the Sudan, we did declare default. Isn't that correct?

Mr. LELAND. We rescheduled the debt.

Senator KASTEN. We did not declare default?

Mr. LELAND. I don't believe we did.

Senator KASTEN. There are several nods saying we did not.

Mr. LELAND. No, we never declared default.

Senator KASTEN. I know you do not want to get involved in the question of the negotiations with the allies, but if possible I would like to express a concern that the Congress has in terms of the pipeline and, particularly, of the reexports.

What kind of an agreement would you be satisfied with from our point of view in order to slow down the pipeline or, let's just say, delay completion of the pipeline for approximately 24 months?

EXPORT CONTROLS AND LICENSES

Mr. HORMATS. We have tried to put the question of the overall undercutting issue in a broader sense. What we have done, through our own governmental actions—mainly the export control restrictions—is to put a number of items under license and then deny the license for those exports. Included in that category are components, that is, subcontracted components for European prime contractors. The prime contractors in turn would have sold those goods to the Soviet Union. Some are for the pipeline; some are for other things.

There have been concerns on the part of the Europeans about this. These relate to the fact that their firms entered into these contracts before these items were even under license.

Also, they are concerned that a certain amount of unemployment would occur if those final products were not able to go to their final destination because of our unilateral restrictions.

Senator KASTEN. I am not so concerned about what we are doing with the licenses that have not yet been granted, but what I am con-

about is the licensing agreements, which have been granted, that we may now seek to withdraw or to slow down.

Mr. HORMATS. That is in this category that I was talking about. In other words, these are items for which there had not been a licensing requirement prior to December 30. Now there is a licensing requirement. The item has been put under license.

Senator KASTEN. And it has been made retroactive?

Mr. HORMATS. That's what they are worried about. The current policy is simply to hold to that provision and not allow those subcontracted items to go, so that they would not be used in the final product of the prime contractor. That is the present position.

Senator KASTEN. It seems to me that we can put substantial pressure on U.S. companies to conform with the basic guidelines that you are talking about, even through their subsidiaries in European countries. It seems to me that it would be more difficult to put that same kind of pressure on European, particularly West German, countries to agree to the same type of limitations.

First of all, you would agree that we can encourage American companies through European subsidiaries not to supply or to slow down certain equipment for the pipeline. So you believe it is possible to negotiate the next step, which is to encourage our allies or European companies not to provide that equipment for the pipeline?

Mr. HORMATS. I think it is going to be difficult, Mr Chairman, for two basic reasons: One is that the Europeans, in terms of their own energy projections, feel a great vulnerability to Middle East supplies of oil and are looking at this as a means of reducing their dependence; and two, because their industries are very weak—they have 10 percent unemployment and the steel industry in particular is weak. They see this pipeline as a very important means of generating employment in a weak market.

Also, they are concerned that if the question is not handled well, it could shift the focus from combined pressure on the Soviet Union and Poland to a major debate between the United States and Western Europe. And I think my own view on the pipeline is that it does involve an inordinate amount of Western vulnerability to the Soviets because of the ability to manipulate the gas supplies, and it provides an enormous amount of hard currency to them which they could use in the future to build up their economy and their military capability.

The question is how do you get at it. I want to be frank with you. I think it is probably today one of the most sensitive issues between the United States and Europe. This is why I made the point about threat. How we handle this may well determine the degree of solidarity among the allies in terms of dealing with Poland and the Soviet Union. Our objective is the same, we both have concerns about the pipeline.

Senator KASTEN. I think there is a bipartisan concern in Congress that we should delay that pipeline. I think there is an understanding that much of the plant, machinery, and equipment that would be used in that pipeline may be used in the Alaska pipeline, so that the things that have been built as scheduled or reordered, could be redirected there.

And I think there is a growing concern and a growing knowledge in the Congress that if we can delay the hard currency that the pipeline would produce, for even 24 months, it will make a tremendous difference. I also think that there is a feeling in this Congress that we are prepared to work with American companies, either directly involved or American companies who are involved through their European subsidiaries. We would like to do what we can to encourage the delay or even the cancellation of certain kinds of equipment that would make that pipeline become a reality sooner.

I am told Senator Moynihan is going to make a statement before the subcommittee. I would like to declare a 1-minute recess.

I thank you for your testimony.

[A brief recess was taken.]

CONGRESSIONAL WITNESS

STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, U.S. SENATOR FROM NEW YORK

INTRODUCTION OF SENATOR MOYNIHAN

Senator KASTEN. The subcommittee will please come to order. We are happy to have with us today the Senator from New York, who has had a longstanding interest in these affairs and who also, according to a dear colleague letter, may be in the process of introducing legislation which would impact this issue.

We are pleased to have as a witness Daniel Patrick Moynihan, the senior Senator from New York.

Senator MOYNIHAN. Thank you, Mr. Chairman. You are very generous to give me this time, past noon, when I know that you have other responsibilities, so I will be brief, sir.

PREPARED STATEMENT AND ATTACHMENTS

I would like, if I may, to put a formal statement in the record, along with a copy of the legislation which I did introduce yesterday and a copy of an editorial on the matter which appeared in this morning's Wall Street Journal. I would also like to put in the record a copy of a long essay I wrote on the general subject at Christmas, shortly after martial law was declared in Poland.

Senator KASTEN. Without objection, so ordered. The documents will be made a part of the record.

[The information follows:]

STATEMENT OF SENATOR DANIEL PATRICK MOYNIHAN

As you know, yesterday I introduced legislation that will require Poland to be declared in default of its debt to American lenders before the United States honors its loan guarantees to the lenders and that I plan to offer an amendment to the upcoming supplemental appropriation bill for the Commodity Credit Corporation that would have the same effect.

Specifically, my proposal S. 2079 would require that Poland be declared in default before any payments could be made by U.S. government agencies (such as the Commodity Credit Corporation or the Export-Import Bank) to American individuals or corporations in satisfaction of debts incurred by Poland and guaranteed by these government agencies. The banks would recieve the money due them according to their contractual agreements with the C.C.C. or the Export-Import Bank. But the lenders would first have to declare that Poland is in default. This requirement that default be declared before loan guarantees could be exercised is not a new notion; the C.C.C.'s own regulations and its loan guarantee agreements with banks required such a declaration until January 29, when the Administration quietly changed the rules as The Wall Street Journal notes this morning, in possible violation of the law.

The need for default is compelling; the argument, I believe, is self-evident.

Two months have passed since the imposition of martial law in Poland and the brutal suppression of Solidarity. Yet the United States and its allies have not found a way to apply meaningful pressure on either the military junta in Warsaw or its masters in Moscow to mitigate or end this repression. Arrests and imprisonment of Solidarity members continue. Lech Walesa remains in confinement and, according to the most senior official of the Catholic Church in Poland, Archbishop Jozef Glemp, the people of Poland are "overcome by anger...enraged" at the suppression of their liberties.

What have we in the West done about the violent disruption of a peaceful, popularly-supported process of democratization in Poland?

The United States has suspended landing rights in this country for the Polish national airline and produced a television spectacular that received mixed reviews. Our response has been near to shameful.

The President and the Secretary of State, and other leaders of the western alliance, have said they will impose harsher sanctions if the situation in Poland does not improve. Two months have gone by; the situation has not improved. It is time to take the next step. I believe default should be the next step.

A declaration of default would add to the financial and economic pressure on the Polish junta and on the Soviets who helped to install it. It would render impossible any commerce by Poland with the West, and make more difficult any trade by the Soviet Union. This pressure would be of the most effective kind, for any effort to resuscitate the moribund Polish economy must require loans and credits from the West. Poland needs manufactured goods that simply cannot be produced in sufficient quantity in eastern Europe. And Poland cannot now afford to purchase these goods without assistance from the West.

While the United States should provide that assistance for as long as Poland is responding to the humanitarian and political needs of its people, I do not believe the United States should provide such assistance in the present circumstances. The United States will only be seen by the Polish people themselves as abetting their military overlords. Moreover, according to the policy put into place by the Administration on January 29 (which would permit the C.C.C. to pay banks for guaranteed loans which Poland has failed to repay without first declaring Poland in default), the U.S. will spend as much as $380 million in American taxpayers' money this year in doing so. Spending money to put pressure on the Soviet tyranny in Poland would be preferable to spending hundreds of millions of dollars to cushion Poland and the Soviet Union from the natural consequences of disasterous economic policies rooted in the suppression of the Polish people.

One important point has been obscured, no doubt unintentionally, by comments of various Administration spokesmen who have indicated that a declaration of default would somehow absolve Poland of all future responsibility for its debt to the West. That is not true. Default is not the international equivalent of bankruptcy for an individual or corporation, wherein an overextended borrower can be relieved of the obligation to pay some or all of its debts through the filing of

bankruptcy papers. Default is simply a declaration by a lender that a borrower has not fulfilled one or more of the conditions agreed to when money was borrowed. The most obvious breach of this sort would be a failure to make the loan repayments on time. This is what has happened to Poland. A declaration of default would entitle creditors to 'accelerate' the loan and demand that the entire loan be paid immed Because of cross-default provisions in most loan contracts, virtually all Poland's debts would come due immediately and creditors would be entitled to seize what real assets mights be available in partial satisfaction. Poland would still be responsible for the remainder of its debt, and would have to pay it before it was able to borrow any more money, or obtain trade credits from the United States. It would also mean that the U.S. Government through various of its agencies, would buy the Polish debt, thus, concentrating it in the lands of the Government.

This is where it belongs. Trade with eastern Europe is strategic ally significant, at least as much as it is commercially important. The centerpiece of detente during the 1970's, after all, was the expansion of this trade with the Communist countries of eastern Europe and it was encouraged by the United States with a purpose in mind. It was thought that this trade would raise the costs to the Soviet bloc of politically destabilizing actions. We would make them dependent on trade with the West. They would be reluctant to disrupt it, and so would behave in ways more acceptable to the democracies. They would not invade other countries, they would not be so bold in the brutalizing of their own people.

What has happened? Afghanistan teaches us one lesson. The suppression of Solidarity seven weeks ago teaches us another.

The theory of detente presupposed a Western willingness to use the economic strength that this trade provided us. If we are ever to exercise our leverage with respect to the Soviets, our strongest form of leverage, the economic, then this is the moment.

doubled in 10 years, and continues to grow rapidly.

Typically today, interest in physical activity begins at an early age, and presently, nearly 30 million boys and girls take part in age-group team sports and other organized out-of-school activities. More than 6 million teenagers and over 600,000 college students compete in athletic programs.

Our physical fitness and sports programs are one of the primary means by which we strengthen and refresh ourselves. It is essential that we publicize such programs and make them increasingly available so that all of our citizens will be able to experience the benefits they offer. Accordingly, I am sponsoring this resolution, which requests President Reagan to declare May 2 through 8, 1982, as "National Physical Fitness and Sports for All Week."

Mr. President, I ask unanimous consent that a copy of the resolution be printed in the RECORD at the conclusion of my remarks.

There being no objection, the bill was ordered to be printed in the RECORD, as follows:

S.J. RES. 143

Whereas one of every two adults in our country is a regular participant in exercise and sports;

Whereas the number of physically active men and women has doubled in ten years and continues to grow rapidly;

Whereas today we recognize that physical activity is an important part of daily life for people of both sexes and of all ages;

Whereas physical activity is vital to good health and is a rich source of pleasure and personal satisfaction;

Whereas our physical fitness and sports programs are one of the primary means by which we strengthen our bodies and refresh our spirits; and

Whereas it is essential that we make fitness and sports programs increasingly available so that all of our citizens will be able to experience the joys and benefits they offer: Now, therefore, be it

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled, That the President is authorized and requested to issue a proclamation designating the week of May 2 through 8, 1982, as "National Physical Fitness and Sports for All Week", and to call upon Federal, State, and local government agencies, and the people of the United States to observe the week with appropriate programs, ceremonies, and activities.

By Mr. MOYNIHAN:

S. 2079. A bill to require that Poland be declared to be in default unless certain liberties and rights are found to be restored in Poland before payments are made by the U.S. Government for loans owed by Poland or credits which have been extended to Poland which have been guaranteed or assured by agencies of the U.S. Government; to the Committee on Banking, Housing, and Urban Affairs.

POLAND'S DEBTS

● Mr. MOYNIHAN. Mr. President, I rise to introduce legislation that would place Poland in default of its international debt.

Specifically, my bill would require that Poland be declared in default before any payments could be made by any U.S. Government agencies, including the Commodity Credit Corporation and the Export-Import Bank, to individuals or corporations in satisfaction of any debts incurred by Poland and guaranteed by these Government agencies.

The need for this legislation is self-evident. On January 29 the administration put in place an extraordinary policy that would permit the Commodity Credit Corporation to pay banks the amounts Poland has failed to pay them for guaranteed loans—without declaring Poland to be in default of its debts. The administration thus chose not to use the leverage this debt had given the United States to encourage an acceptable political accommodation in Poland. In the words of The Wall Street Journal editorial of February 3:

It looks as if the battle for freedom in Poland is going to have to be taken to the floor of the U.S. Congress.

My bill will provide Congress that opportunity.

I look forward to an early debate in the Senate on this question, Mr. President.

For the information of Senators, I ask unanimous consent that my legislation be printed in the RECORD following the insertion of several analyses of the Polish debt.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

[From The Wall Street Journal, Feb. 3, 1982]

CONGRESS'S CHANCE ON POLAND

It looks as if the battle for freedom in Poland is going to have to be taken to the floor of the U.S. Congress. With Ronald Reagan's administration slipping into tacit collaboration with martial law by making it easier for the Soviet bloc to finance repression, any serious action against the Polish regime will have to be taken by another branch of government.

It turns out that the administration, far from calling in the Polish debt to hamper the flow of credit to the Soviet Union and its satellites, is bending U.S. law to keep Poland out of bankruptcy. The Commodity Credit Corporation provides government guarantees to banks financing grain shipments abroad, offering to repay the banks if foreign governments cannot. For ordinary, non-Communist governments, no payment is made until the bank declares the loan in default. But in the case of Poland, this was deemed too embarrassing.

So the State Department lobbied to change the CCC rules, and the administration decided to pay off $71 million to the banks without their declaring a formal default. This is a down payment on about $400 million in guarantees on Polish loans due this year. No sooner is the decision taken than Secretary Haig rushes off to Chicago to spend Solidarity Day posturing before Polish voters as a tough guy on Poland.

One point that begs attention is how this decision was reached. At what level of the government was it decided? Did the President understand the full implications of the change in the rules? Did the National Security Adviser? Where was the Treasury? (The undersecretary for monetary affairs says he's under instructions not to discuss the issue.) Was the Defense Department even consulted? Was this the foreign policy equivalent of the decision to change the tax status of segregated private schools? Everything we learn leads us to suspect that the answers to these questions would be profoundly embarrassing, that this is another example of sloppy management at the White House.

A second point concerns the banks. They have refrained from declaring a default in Poland because the writedowns would hurt their earnings. It would also hurt their chances of doing new business with the Communist dictators of Poland and the rest of the Soviet bloc. But the real question is how did U.S. and other Western banks make all these bad loans, and how can we stop them from doing it again?

The banks have made the loans because Western governments encouraged them to do so, implicitly suggesting that loans to Communists had a favored position, deserved lower rates and would more or less be backed by Western governments. The CCC deal can only encourage this notion. The Soviets rushed to get the gas pipeline deal and other credits wrapped up before the Polish crackdown, and with the new incentives just demonstrated by the Reagan administration, the flow of credit will resume again as soon as the bad press dies down.

The U.S. government ought to at least stay neutral toward Communist loans. The Polish loans clearly are sick, and probably terminally so. The banks ought to be establishing large reserves against them—we have previously suggested 50%—as a matter of pure commercial prudence. The government ought to be encouraging them to do this, not helping them avoid it, to limit the commercial damage from any forceful foreign policy initiative. Instead, the Reagan administration sponsors a TV show.

Fortunately Congress will have an opportunity to show greater forcefulness, for it controls the power of the purse and bail-out money has to come from somewhere. Specifically, it would come from House Joint Resolution 389, a budget-busting supplemental appropriation of $5 billion for the CCC. This measure has been marked up—with unseemly haste—in the agriculture appropriations subcommittee by the Mississippi Democrat, Jamie Whitten. The main purpose is to provide pork for American farmers, who are calling on their CCC entitlements because of low farm prices. But a lot of the money—between $500 million and $1.5 billion, so far as we can learn—could be used to bail out repression in Poland.

It would not be the worst thing in the world if this whole supplemental were grounded, farm price supports being one of our least favorite subsidies to the landowning poor. But if Congress is going to bail out the American farmer, it can at least write in an amendment prohibiting the use of these tax funds to bail out Polish dictators, at least until a default is declared and the economic lessons of Poland digested.

[From the New York Times, Feb. 5, 1982]

DEFAULT IS REAGAN'S

(By William Safire)

WASHINGTON, Feb. 4—With all due solemnity, the White House press office has declared that the memo quoted in this space a few days ago—revealing national security adviser Clark's order to secretly circumvent regulations requiring that Poland be placed in default—was a leak of classified information, subject to the latest lie-detector rules.

This is an illustration of the arrogance of ignorance. Mr. Clark evidently thinks that

his power to stamp "secret" on documents affecting national security extends to documents that are merely politically sensitive. confusing what is genuinely secret with at is politically embarrassing, he abuses his power to classify.

For example, his order to protect Poland from normal default procedures was passed along to at least seven major American banks at noon Friday of last week. The Polish junta was promptly informed; the ast German banks were notified; the remlin knew all about it. The only people not in on Mr. Clark's "secret" was the American people, whose tax money was being used to make good Poland's debt.

Moreover, Mr. Clark's improper use of his classification power could have made it possible for bank insiders to benefit from information denied to the investing public. The $71 million payment was good news for worried bankers; perhaps bank stock activity was wholly unrelated to this development, but the Clark abuse of secrecy made a mockery of S.E.C. "full disclosure" requirements.

The abuse of the classification power was compounded by the cover-up that followed. A party line was propounded at State that turned truth on its head: the cave-in to the junta's financial needs was described in testimony to Senate Percycats as a triumph of toughness. Default, went this Orwellian argument, would let the debtor "off the hook"; only by preventing default, insisted the Secretary of State, could we recover our money.

In the case of sovereign nations, that alibi is palpably false. Countries are not corporations with limited liability; when Poland defaults, it must make good on its debts before getting credit again. The same with Rumania, next on the Clark-Haig list for largesse. Default is sustained and serious pressure, and is not relief from pressure. Nor are we trying to recover money; we are trying to end martial law. The Reagan Administration is deliberately misinforming American taxpayers on this at great risk to its own credibility.

William Clark, hailed as a problem-solver, is thus creating great problems with his secrecy-sycophancy and alibi-cooking. For another example, take the case of William Van Cleave, a long-time policy adviser to candidate Reagan.

The outspoken Mr. Van Cleave was denied a job at State by Haig détenteniks and shut out of Defense by Frank Carlucci, the lie-detector king. As a sop to hard-liners, the campaign deputy to Richard Allen was named to head the advisory board on arms control, even after he made clear in writing he would continue to dissent on the MX decision.

This week, Mr. Clark called Mr. Van Cleave into the White House and said that even the sop would be denied. "The vote was 3 to 1," sympathized the new national security adviser. It seems that Messrs. Baker, Deaver and Meese—there's a bunch of foreign policy experts—had opposed Mr. Clark on the nomination. Soft-liner Percy's opposition turned out to be more important than hard-liner Eugene Rostow's support. Strangely, Ronald Reagan was never asked to cast a vote.

To conservatives, Mr. Clark put forward the alibi that only Mr. Van Cleave's publicly expressed dissent to MX blocked him from the post he had afterward been promised. That is demonstrably false, but as in the case of the Orwellian explication, Mr. Clark sticks to his story and further erodes his credibility.

What is Bill Clark's game? By pandering to the President's irritation with dissenters and whistle-blowers, he undermines the tottering troika; by tolerating the humiliation of Mr. Van Cleave, he gains the chance to substitute Donald Rumsfeld in that slot and thus to send a chill through Al Haig.

But he is not knowledgeable enough to take charge himself; no interviewers are permitted to probe his thoughts, thereby to suggest that still waters may run shallow. Why, then, is President Reagan bringing Mr. Clark along so fast?

My guess is that the President wants an amiable no-liner to make peace between the high-riding détenteniks and the gloomy hard-liners at Defense, so that he can continue to concentrate on those domestic challenges that interest him most. Next year, he may figure, will be time enough to bring in a second wave of foreign policy makers.

What a mistake. Americans threw out Jimmy Carter because they believed him to be uncertain and impotent on the world stage. Next year will be too late for the creation of a coherent foreign policy. Default, dear Brutus, is not in our advisers; as abuses grow and alibis fly, the blame is placed in the Oval Office.

[From the Washington Post, Feb. 7, 1982]

No, It Would Only Hurt Some Foolish Banks

(By George F. Will)

Everyone needs a hobby, and Teddy Gleason's hobby is stiffening U.S. foreign policy. He is head of the International Longshoremen's Association, and if the Reagan administration will not seriously restrict trade with the Russian and Polish regimes that are brutalizing Poland's labor movement, Gleason's men may do it, as they have before.

Gleason's foreign policy would be a distinct improvement on the government's. The government has paid $71 million to U.S. banks in lieu of interest payments Poland owes on loans the U.S. government guarantees. The payment was contrary to the law, which requires prior notice of default. Indeed, the purpose of this surreptitious payment was to prevent Poland from being declared in default, which would disrupt East-West trade and efforts to resuscitate détente.

"The United States," says Secretary of State Alexander Haig, "has made it clear that we will not do business as usual with either Poland or the Soviet Union while repression in Poland continues." Indeed, it is highly unusual to ignore U.S. law in order to subsidize Poland's martial law. To do otherwise, Haig says, would "bring down the temple of Western unity." Temple? All that would be brought down would be the earnings of some foolish bankers.

Eastern Europe's economies, which help sustain Russia's war economy, have received Western loans four times the value of all American aid to Western Europe during the Marshall Plan. Russia is so pressed for hard currency it is asking Japanese and West German companies to stretch out payments for goods shipped to Russia. Yet, as The Wall Street Journal says, the administration is "slipping into tacit collaboration with martial law by making it easier for the Soviet bloc to finance repression."

Even before the $71 million payment, administration policy regarding Poland was dismally congruent with the general Western response, which The Economist magazine says will be remembered as the Great Handwringing of 1981-82. Democrats are noticing the opportunity to pluck from the administration's palsied grasp the falling flag of national honor, and to do so by opposing bankers on behalf of a large ethnic group.

Haig has had his way with the U.S. response to Poland's crisis and has become a hostage to fortune. He says the crisis has just begun and America must hold all serious measures in reserve for when the going gets rough. But what additional suffering by Poland could provoke action from people who worship at the "temple" of allied unity?

In Cuba, Russia long ago, repealed the Monroe Doctrine and now, with the recent arrival of heavy bombers, advanced fighters and 63,000 tons of war material, it is shredding whatever is left of whatever agreement was reached at the end of the missile crisis 20 years ago. Haig is adamant, and correct, concerning the need for difficult decisions about El Salvador and the source of much other violence, Cuba. But he seems oblivious to certain problems inherent in the conduct of foreign policy in a democracy—oblivious to the practical consequences of symbolism, and to the demoralizing symbolism of America's policy regarding Poland.

Always, but especially when the president is preoccupied with domestic policy, the nation needs a secretary of state with some of Dean Acheson's attributes—someone articulate, intellectual, elegant, ironic, at ease with himself, and justifiably confident of his ability to argue America's case before skeptical elites at home and abroad. The Achesonian combination of attributes is rare, but Haig's lack of them is a problem compounded by a policy toward Poland that is certain to confuse and paralyze the nation's will. In the early 1970s, the rhetoric and other atmospherics of détente—the "end of the Cold War," "an era of negotiation, not confrontation," accords on "principles of conduct"—subverted public support for diplomatic and defense measures arduous enough to prevent détente from becoming what it became: a recipe for American retreat and an incitement to Russian expansionism. Haig then understood the problem and was a corrective force.

Today, administration policy regarding Poland is generating similar confusion and lassitude that will color defense and foreign policy debates generally. Haig argues that paying Poland's interest charges is really the "tough" policy because it keeps Poland under the burden of debt. That argument is entertainingly brassy, but it is too clever by half, which means it is not clever at all. Even if it were true, it would be politically unwise.

Someone who argues that subsidizing Poland's generals is toughness will find that when he turns to talking of other, more recognizable, forms of toughness in Central America, the public is not deferential, or comprehending, or even attentive.

S. 2079

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That no funds may be paid out of the Treasury of the United States to any private individual or corporation in satisfaction of any assurance agreement or payment guarantee or other form of loan guarantee entered into by any agency of the United States Government with respect to loans made and credits extended to the Polish People's Republic, unless either—

(1) the Polish People's Republic has been declared to be in default of its debt to such individual or corporation, or

(2) the President certifies to the Congress that civil liberties and the rights of free trade unions have been restored in Poland to such a degree that it would be appropriate for the United States Government to promote commerce with Poland in order to protect and expand those liberties and rights.

SEC. 2. The President may delay implementation of this Act for up to 30 days after the date of enactment if he determines, and so notifies Congress, that to do so would be necessary and desirable in order to coordinate the response by monetary authorizes in the United States and in member countries of the Organization of Economic Cooperation and Development to a Polish default.●

ADDITIONAL COSPONSORS

S. 1215

At the request of Mr. PROXMIRE, the Senator from Michigan (Mr. RIEGLE) was added as a cosponsor of S. 1215, a bill to clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws.

S. 1634

At the request of Mr. COCHRAN, the Senator from Oregon (Mr. HATFIELD), the Senator from Wisconsin (Mr. PROXMIRE), the Senator from Arkansas (Mr. PRYOR), the Senator from Illinois (Mr. PERCY), and the Senator from Alabama (Mr. DENTON) were added as cosponsors of S. 1634, a bill to incorporate the National Federation of Music Clubs.

S. 1693

At the request of Mr. KASTEN, the Senator from Arkansas (Mr. PRYOR), the Senator from Georgia (Mr. MATTINGLY), the Senator from North Carolina (Mr. EAST), the Senator from Iowa (Mr. GRASSLEY), and the Senator from New Mexico (Mr. DOMENICI) were added as cosponsors of S. 1693, a bill to provide for the issuance of a special stamp to commemorate the 200th anniversary of the presence of the bald eagle on the official seal of the United States of America.

S. 1958

At the request of Mr. DOLE, the Senator from New Jersey (Mr. WILLIAMS), the Senator from Indiana (Mr. LUGAR), and the Senator from North Dakota (Mr. BURDICK) were added as cosponsors of S. 1958, a bill to amend title XVIII of the Social Security Act to provide for coverage of hospice care under the medicare program.

S. 1992

At the request of Mr. MATHIAS, the Senator from Georgia (Mr. MATTINGLY) was added as a cosponsor of S. 1992, a bill to amend the Voting Rights Act of 1965 to extend the effect of certain provisions, and for other purposes.

S. 1996

At the request of Mr. DOLE, the Senator from Florida (Mrs. HAWKINS) was added as a cosponsor of S. 1996, a bill to provide for more effective deterrents for violent crime offenders.

S. 1997

At the request of Mr. DOLE, the Senator from Florida (Mrs. HAWKINS) was added as a cosponsor of S. 1997, a bill to provide assistance to State and local governments in combating crime.

S. 2009

At the request of Mr. KASTEN, the Senator from New Hampshire (Mr. RUDMAN) was added as a cosponsor of S. 2009, a bill to amend the Internal Revenue Code to eliminate special rules for leases.

S. 2012

At the request of Mr. PROXMIRE, the Senator from Hawaii (Mr. MATSUNAGA) was added as a cosponsor of S. 2012, a bill to amend the Internal Revenue Code of 1954 to limit the deduction of living expenses by Members of Congress and to eliminate the provision which allows such deduction without substantiation of such expense.

S. 2013

At the request of Mr. INOUYE, the Senator from Virginia (Mr. WARNER), and the Senator from Kansas (Mr. DOLE) were added as cosponsors of S. 2013, a bill to amend the Controlled Substances Act to establish a temporary program under which heroin would be made available through qualified hospital pharmacies for the relief of pain of cancer patients.

S. 2027

At the request of Mr. ROBERT C. BYRD, the Senator from Oregon (Mr. HATFIELD) was added as a cosponsor of S. 2027, a bill to provide for an accelerated study of the causes and effects of acid precipitation, to provide for an examination of certain acid precursor control technologies, and for other purposes.

SENATE JOINT RESOLUTION 140

At the request of Mr. MATHIAS, the Senator from Arizona (Mr. GOLDWATER), the Senator from Kentucky (Mr. HUDDLESTON), the Senator from Alabama (Mr. HEFLIN), the Senator from Hawaii (Mr. INOUYE), the Senator from Massachusetts (Mr. KENNEDY), the Senator from Michigan (Mr. LEVIN), the Senator from Indiana (Mr. LUGAR), the Senator from West Virginia (Mr. RANDOLPH), the Senator from Tennessee (Mr. SASSER), the Senator from Vermont (Mr. STAFFORD), the Senator from Idaho (Mr. SYMMS), the Senator from Massachusetts (Mr. TSONGAS), the Senator from Virginia (Mr. WARNER), the Senator from New Jersey (Mr. WILLIAMS), the Senator from Alabama (Mr. DENTON), the Senator from New Mexico (Mr. DOMENICI), the Senator from Missouri (Mr. DANFORTH), the Senator from Arizona (Mr. DECONCINI), the Senator from New York (Mr. D'AMATO), the Senator from California (Mr. CRANSTON), the Senator from Nevada (Mr. CANNON), and the Senator from Washington (Mr. GORTON) were added as cosponsors of Senate Joint Resolution 140, a joint resolution designating February 11, 1982, "National Inventors' Day."

SENATE CONCURRENT RESOLUTION 62

At the request of Mr. HATCH, the Senator from Wisconsin (Mr. KASTEN), the Senator from Minnesota (Mr. DURENBERGER), the Senator from Indiana (Mr. LUGAR), the Senator from Washington (Mr. GORTON), the Senator from Maine (Mr. COHEN), the Senator from Oregon (Mr. PACKWOOD), the Senator from Minnesota (Mr. BOSCHWITZ) were added as cosponsors of Senate Concurrent Resolution 62, a concurrent resolution to congratulate Hadassah, the Women's Zionist Organization of America on the celebration of its 70th anniversary.

SENATE RESOLUTION 261

At the request of Mr. CHAFEE, the Senator from Pennsylvania (Mr. SPECTER) was added as a cosponsor of Senate Resolution 261, a resolution expressing the sense of the Senate that the President should not impose import fees on crude oil and refined petroleum products.

SENATE CONCURRENT RESOLUTION 64—CONCURRENT RESOLUTION RELATING TO A RECEPTION IN THE CAPITOL ROTUNDA

Mr. ROBERT C. BYRD (for Mr. PELL) submitted the following concurrent resolution; which was considered and agreed to:

S. CON. RES. 64

Resolved by the Senate (the House of Representatives concurring), That the Zeta Beta Tau fraternity is authorized to conduct a reception in the rotunda of the Capitol on March 31, 1982, to commemorate Roger Williams for his contribution to religious toleration and freedom in the United States. The reception shall be conducted in accordance with such conditions as may be prescribed by the Architect of the Capitol.

SENATE RESOLUTION 314—RESOLUTION RELATIVE TO THE LIFE OF DR. ARTHUR M. BUECHE

Mr. SCHMITT (for himself, Mr. BAKER, Mr. D'AMATO, Mr. JACKSON, Mr. MOYNIHAN, and Mr. RIEGLE) submitted the following resolution; which was considered and agreed to:

S. RES. 314

Whereas, Dr. Arthur M. Bueche, as one of the outstanding scientists and engineers in the United States, made substantial and enduring contributions over his lifetime to science, industry, Government service, and education;

Whereas, the United States continues to face an era of increasingly complex problems depending on scientific and technological progress for solutions;

Whereas, Dr. Bueche devoted his individual research efforts in the field of material sciences pioneering the development of synthetic rubber and silicons, obtaining many patents, publishing dozens of outstanding papers and reports, and was an active participant and officer in numerous scientific and technical societies.

Whereas, Dr. Bueche has been widely praised for his management skills in industrial research, resulting in breakthroughs in the fields of electronics," materials science and energy, and implementing innovative approaches for rapidly converting laboratory achievements into products benefitting mankind. Among these products are: an advanced computer-directed axial tomography X-ray (CAT) scanner, stronger and safer plastic materials, extraordinarily hard mate-

THE WALL STREET JOURNAL, TUESDAY, FEBRUARY 9, 1982

De-faulty Logic on Poland

The Reagan administration is resorting to twisted logic to defend its financial bailout of Poland's military dictators. Assistant Treasury Secretary Marc Leland said last Friday that declaring Poland in default of its loans would give its leaders an excuse to ignore its financial obligations. "The President has decided that maximum pressure can be put on Poland by insisting on repayment rather than declaring a default now," Mr. Leland said.

"Maximum pressure," we take it, consists for example of having U.S. taxpayers foot the bill for Poland's loans under the Agriculture Department's Commodity Credit Corp. The administration plans to pay $71 million to U.S. banks for Polish CCC loans that are already overdue. The U.S. government last year paid U.S. banks $158 million in guarantees on rescheduled Polish debt. Poland still has over $1.6 billion in outstanding CCC loans, some $300 million of which is due this year.

It now turns out that the administration's CCC decision is also of doubtful legality. The Capital Legal Foundation has developed a brief that the decision to repay the loans without a formal declaration of default violates the CCC's own rules and regulations. The rule required banks to first give notice of nonpayment, which might trigger the cross-default provisions in other loan agreements, and then for the government to confirm the finding before any government payment.

These rules were not followed in the case of Poland. Nor did the administration follow the established procedures for changing the rules, which provide that it must either publish the changes in the Federal Register and allow time for public comment, or specifically declare an emergency and explain why. The CCC of course defends its interpretation of the law, but the banks themselves are pondering the legality of the unorthodox arrangement, as well as certain CCC changes in interest provisions, before deciding whether to accept the money. They have until Feb. 13 to decide.

Contrary to putting "maximum pressure" on the dictators in Warsaw and Moscow, the administration's actions permit the Communist bloc to escape—for at least a time—the harsh financial consequences of Poland's de facto default. A declaration of default would put intense financial and political pressure on the Communist bloc. Polish trade would probably come to a standstill, at least until a strict repayment plan was agreed on. Bankers would be forced to look more skeptically at all East bloc loans, depriving the Soviet economy, and indirectly its military machine, of the kind of infusion of credit it has enjoyed the last decade.

While the Reagan administration is reluctant to take such a strong step, several members of Congress are not. Senator Patrick Moynihan yesterday introduced a bill to declare Poland in default of all of its loan obligations to the U.S. Today Sen. Moynihan and Rep. Jerry Lewis plan to introduce floor amendments to a $5 billion supplemental appropriation for the CCC requiring the agency to abide by its own rules and to receive default notices before any payments are made on Poland's debt.

Thus Congress will have its chance to be heard. Perhaps it will have the courage of Mr. Reagan's convictions.

Washington, DC
December 26, 1981

DEAR NEW YORKER,*

The holidays are a time to reflect on the year past and to hope for peace and happiness in the year ahead. Christmas, as an official holiday, came late to the United States. The English Puritans detested it as a papist rite, and there were laws against its observance in the Commonwealth of Massachusetts. The Scots celebrated on New Year's. The Germans kept Christmas, as they say, but in those days also kept somewhat to themselves.

The first Christmas tree in the White House was the inspiration of one of those Presidents of the 1880s whose sequence I can never keep straight. This was imported behavior, Prince Albert having introduced the custom to Buckingham Palace a generation earlier. But it was not until 1894 that Grover Cleveland, perhaps responding to his political experiences among the German folk of Buffalo, gave the civil service the day off. The occasion has been, in that sense, sacred ever since. The Capitol shuts down, and becomes rather a private place. For once, all is calm. It is possible to think.

This year, all it has been possible to think about is Poland, and it has been heartbreaking.

Three years ago I published a book about my experience as ambassador to India and to the United Nations. I began with a bit of biography: I had first gone to Washington, I wrote, with John F. Kennedy and then stayed on with Lyndon Johnson. "There I learned as an adult what I had known as a child, which is that the world is a dangerous place -- and learned also that not everyone knows this." My editor picked up the phrase -- the theme, if you like -- and the book was given the title A Dangerous Place.

Nothing has happened since to change this view. Looking back, that is, from the vantage of the day after Christmas, 1981. But in between something did happen. Solidarity. "Solidarność," in the Polish language with which we are all becoming familiar.

A Season of Solidarity

This is to say that, in the midst of a Communist state, on the very border of the Soviet Union and thanks to the Warsaw Pact, not only surrounded by Soviet armed forces but half occupied by them (there are two Soviet tank divisions stationed permanently on Polish soil, and "maneuvers" recurrently bring larger forces across the border), a free trade union movement was organized and seemingly moved from strength to strength. It grew incredibly in numbers. Two weeks ago Solidarity had some ten million members, perhaps half the adult population of Poland. Its leaders developed uncanny organizational skills, and its membership learned discipline. One-hour strikes would begin exactly at noon and end precisely at one o'clock and close down a whole city.

Solidarity's demands were elemental and just. It sought the right to free association. To free speech. To a somewhat better life for the working people of Poland. It brought down one set of Communist Party leaders. It forced that group's successors to the bargaining table. It obtained formal contractual agreements. It produced an extraordinary leader, Lech Walesa. A man of the people, he was a shipyard electrician.

For years, persons in government and universities (myself included) have made their living teaching that this was not possible. The 20th Century Marxist-Leninist state, first we learned, then we taught, was something wholly new in the history of man. It was all powerful and implacable. It would never share power; it would permit no opposition. It was total. No institutions were permitted to exist independent of the state. And it endured. No such state was ever transformed from within.

* You will note the new salutation, replacing "DEAR YORKER," which I have used since commencing this newsletter. Though "Yorker" is a term with a proud history, residents of our state have written to tell me they are equally proud to call themselves "New Yorkers." So am I.

(That none should, that the course of history would make such an event impossible, is fundamental to Soviet belief. This is why the events in Chile in the mid-1970s assumed such importance for them, and retain that importance. It would be hard to find a country as far away from the Soviet Union, or of less consequence to it, than this South American country. Yet to this day, at any United Nations meeting, Chile will be found at the top of the agenda, along with Israel and South Africa, several hours devoted to ritual condemnation. Why? The current regime in Santiago is awful, but is it so much more awful than those of its neighbors? Or of the common lot of U.N. members? Not really. Yet it has seemed to defy historical determinism. It was, at one point, about to become a Marxist-Leninist state -- or so, evidently, it seemed to the Soviets -- and then did not. It may, for all I can testify, have become an even nastier state from our own point of view. But that is not what troubles the Soviets. What troubles the Soviets is that history, as they assumed it was working, didn't.)

A Theory of History

Moreover, by the 1970s United States foreign policy had gone beyond accepting this conclusion; it had commenced to accommodate to it. There had been a period when American policy at least intimated that it favored the "liberation" of the "satellite" nations. But that was talk of the 1950s, and never more than talk.

The Helsinki accords of 1975 accepted the military map of 1945 as legitimate, promising only that certain human rights would be accorded people in Eastern European countries. This was sincere American and Western European policy, but equally sincere was the desire not to have trouble there. An epiphany of sorts came in December 1975, at an otherwise routine meeting of American ambassadors in London. Helmut Sonnenfeldt, then Counselor to the Department of State, spoke to the group. Someone took notes and they soon made their way into the press. Sonnenfeldt had remarked how much it was to be regretted that the Soviets were still so inept in their role as an emergent "superpower on a global scale." He explained: "They have not brought (to it) the ideological, legal, cultural, architectural, organizational and other values and skills that characterized the British, French and German adventures." Alas, also, "the Soviets' inability to acquire loyalty in Eastern Europe is an unfortunate historical failure. . . ." Accordingly, the United States must help. "We seek to influence the emergence of the Soviet imperial power by making the base in Eastern Europe more natural and organic, so that it will not remain founded in sheer power alone. . . ."

This view permeated official thinking. I suppose it is the case that President Ford made an honest mistake ten months later when, in a debate with Jimmy Carter, he declared that the Polish people were not under Soviet domination and were as free as we are. But that is the kind of error that comes from reading too many State Department briefing books.

President Carter was similarly affected, or so I would judge. On December 17, during the first week of Poland's martial law regime, he gave his first foreign policy address since leaving the White House, speaking before a meeting of the Council on Foreign Relations in New York City. His prepared text did not even mention Poland. Such is the power of doctrine! Specifically of the Sonnenfeldt Doctrine, as it came somewhat cynically to be known (which was not entirely fair to the decent career officer who was setting forth, as best he understood it, the position of his government in a setting that seemed to permit more than normal candor). For that was the object behind the American and, generally speaking, Western credits and trade agreements, grain sales and whatever, that began to shower on the Soviets and the Eastern bloc nations at this time. A doctrine of "entanglement" grew up which held that as the Communist nations came more and more to depend on the Western economies, they would necessarily grow more cooperative and less adventurous.

A Doctrine of Entanglement

Alas for the hard life of the theoretician. For it was just at this moment that Soviet policy commenced its most adventurous period since the end of the war. Cuban and Soviet troops were sent to Angola; Soviet forces under the command of a Soviet general appeared in Ethiopia; Afghanistan was invaded; events took an disheartening turn in Nicaragua . . . and so it has gone.

Almost any successful diplomacy involves the ability to see the world from the point of view of other parties. Unless you know how another nation

A Diplomacy of Textualism

will interpret your actions, you are not likely to have much success influencing its behavior. Southerners have a saying that even a blind hog finds an acorn sometimes; but random luck is not a good basis for a mature foreign policy, and mature diplomats work hard at seeing the world from the vantage point of those with whom they deal. This is an exercise not without risks: many an ambassador succumbs to an overseas ailment known as "clientitis." The British call it "going native." But it is a necessary risk, and considerably lessened if there are texts to go by.

This is peculiarly the case both with our country and the Soviet Union. Read The Federalist, the work of Madison, Hamilton, and Jay, and you will know a lot about America. Read Lenin and you will know a lot about Russia. If you do both you will note how very much more the Soviet system is based on prophecies about future events in this world. Theirs, as they say, is scientific socialism which explains historically-determined events.

The first such event was to have been the collapse of capitalism. In the middle of the 19th Century, Karl Marx made this prophecy. The industrial revolution was in full swing at the time, but he saw this amazing transformation of man's condition coming to an early end. Briefly -- if you are still with me -- the wonderful new machines would overproduce. Capital would try to maintain its margin of profit by squeezing more out of labor. Labor, impoverished, would buy even less. And so it would go until the final crash. His book, remember, was called Das Kapital -- Capital.

A Prophecy of Calamity

But the old century ended and the new one began and still no crash. Worse yet, the standard of living of workers was still going up, not down. Lenin came to the rescue with a revision of the prophecy: Imperialism had extended the life of capitalism. By taking over Africa and Asia, capitalism would create new markets for Western goods, thus postponing the collapse. Note that in Lenin's view the imperialists did not exploit the colonies. Rather, they enriched them by sending out their surplus production. I know that sounds wrong, but that is what he wrote. And it is crucial to understanding Soviet behavior today, because once in power Lenin further prophesied that the West would commence dumping its surplus product on the Soviet Union as well.

There are many accounts of this prophecy. In its most simple and widely- held version, Lenin tells a comrade, Karl Radek, "The imperialists are so hungry for profits that they will sell us the rope with which to hang them." There does not appear to be any solid textual evidence that Lenin ever actually said this. However, there is reason to believe he wrote something similar. Shortly after Lenin's death, the Russian artist I. U. Annenkov copied the following passage from Lenin's papers (which years later appeared in the New York Russian-language publication Novyi Zhurnal):

> *. . . The capitalists of the whole world and their governments in their rush to conquer the Soviet market will close their eyes to the activity referred to above [various diplomatic subterfuges of the Soviet government] and will thereby be turned into blind deaf mutes. They will furnish credits which will serve us for the support of the Communist Party in their countries and, by supplying us materials and technical equipment which we lack, will restore our military industry necessary for our future attacks against our suppliers. To put it in other words, they will work on the preparation of their own suicide.*

Is it not a problem that our recent behavior appears to confirm Lenin's prophecy? Following the invasion of Afghanistan, President Carter put an end to our sale of (surplus) wheat to the Soviets. Argentina and Australia quickly made up the difference. Came the 1980 Presidential election and candidates competed with one another in proclaiming their anticommunism and the speed with which, if elected, they would end the grain embargo. As it happened, Ronald Reagan was elected and it fell to him to do so, but most of his rivals would have done so as well.

Consider the famous Yamal pipeline that will bring Siberian natural gas to Western Europe. At a summit meeting of Western leaders held in Ottawa last July 19 through 21, the President proposed that the West not provide the credits and technology to build the pipeline. A week later, however, on July 29, it was announced that the administration had approved an export

license for the Caterpillar Company to sell the Soviets pipe-laying equipment such as they would need need to build the pipeline.*

Now it happens the President's decision was made impulsively, at a meeting in the Cabinet room with the Republican congressional leadership. The Caterpillar Company of Peoria, Illinois is in trouble, the Republican leader of the House of Representatives is from Peoria, and so forth and so forth. Even as the President was making his decision, the State Department was working up an "options paper." But this is precisely the point. No one is to "blame," at least from the Soviet point of view. Everyone acted as they had to act. Having glutted the American market with tractors and earth moving equipment, the Caterpillar company had "to rush to conquer the Soviet market . . . supplying us materials and technical equipment which we lack. . ."

The problem for us in Lenin's prophecy is that he wasn't all that wrong. All the more important then to keep in mind that when we behave as we do, we shore up an otherwise collapsing set of Soviet doctrines.

At a Christmas lunch last week a friend from the Department of State was predicting (correctly) that our allies would resist any real economic sanctions against the Soviets and even political sanctions, such as taking the issue to the United Nations. He gave a good imitation of a career diplomat explaining away the need for Western action by assuring everyone that by crushing Solidarity the Soviets will only show the world that "Communism does not work." "To the contrary," said another friend present, "they show the world that Communism does work." The all powerful, pitiless, totalitarian state.

* * * * * * *

When news of the military repression of Poland arrived in Washington, the United States ought instantly to have gone to the United Nations Security Council and declared that so massive a violation of human rights, so patent an intervention by one nation in the internal affairs of another, was a threat to international peace and security and must be condemned. As I write, the administration has decided not to do this, having first decided it would. The fear is that we would stand alone. Am I wrong in thinking that Madison, Hamilton, Jay stood alone? This is what our books are supposed to tell the world about us.

A dear friend, a lady born in Central Europe who was put in jail by the Nazis during World War II and by the Communists afterwards remarked the other day: "Are we losing our capacity for moral behavior?" Let us hope not. Let us hope for a better year. While we pray for Poland. Pray for the men and women described by the Soviet news agency, TASS, as "counter-revolutionary scum," but who we know to be patriots for whom no praise can be too great.

Sincerely,

Daniel Patrick Moynihan

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* Two points: (a) the license was granted on the basis of an understanding that these 100 pipeline-laying machines, which have already been delivered, would not be used on that pipeline; (b) one consequence of the sanctions announced by the President on December 29 was the suspension of consideration of license to sell an additional 200 Caterpillar machines.

STRATEGIES IN DEALING WITH EASTERN MARXIST GOVERNMENTS

Senator MOYNIHAN. I would wish only to make two points. The first may seem a bit theoretical, but it seems to me essential.

In trying to develop a strategy from the Western viewpoint in dealing with the Marxist governments of the East, it seems to me essential to realize that you are dealing with a people of the book, whose lives revolve around prophecies that have been made about what is going to happen on Earth in their time, or in the very proximate future.

The pivotal work of prophecy remains more than a century later a book written by Karl Marx. Remember that Marx's book was not entitled "Communism," "Socialism," or "Happiness," or any such thing. It was entitled "Capital," and he had a very simple proposition to which he came following his particular kind of analysis. He determined that it is the nature of capitalist industrial society for the rate of return of capital to decline because of overproduction. He didn't see the impact of technology, of course. In the effort to preserve the return to capital, Marx's theory meant employers necessarily would emiserate the working class, squeezing all they could out of it, making life absolutely intolerable. Even so, the profits would keep declining and in the end the system would crash.

But then, contrary to the theory, out of the wind comes happiness. "Das Capital" was published in London in 1859. Over the next 50 years, however, things did not get worse, but they manifestly got better. Capital was doing fine and labor's lot had improved.

Along came Lenin with a critical revision of Marx. He explained how capitalism had survived. It was because capitalists had developed imperialism, which was a means of exporting their surpluses to other countries. Lenin's imperialism was not a device for exploiting other countries, but a means of sending the excess production of the capitalist countries to new markets.

Don't try to explain this to a delegate of a Third World country in the U.N. delegates' lounge. The function of imperialism, according to Lenin, is to export, dump goods on other countries, because you have to dispose of the overproduction of material goods. And that, he said, had kept the Western system going.

Lenin came to power and in a series of exchanges—the one about giving us the rope that we'll hang them with is probably apocryphal—he said the Western nations will have to help our economy develop.

It is the only way they can get rid of their surpluses. They must do it. They will lend us the money and give us the surpluses. That is the only way they can survive.

WESTERN SURPLUSES

Now, sir, their prophecies haven't been working out very well in many other respects. Their state hasn't withered away, et cetera, et cetera, but the one conspicuous success has been this prophecy regarding what we will do with our surplus. They think of our grains as surplus. They think of our Caterpillar tractors as surplus. They expect the capitalists to send these things to them. And we do.

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Just last July, at the Ottawa Summit, the President of the United States said he tried to persuade the Western nations not to go along with a Soviet plan to build a pipeline to carry natural gas from Siberia to Western Europe. He then went back to Washington and 12 days later issued an export license for the Caterpillar Co. to send pipelaying equipment to the Soviet Union. Now that is exactly what the Soviets expect will happen.

U.S. RESPONSE TO SOVIET REPRESSION OF POLISH SOLIDARITY

I said in this little essay, which I wrote the day after Christmas and have put in the record, that the Soviets expect they know what we will do in response to their decision to destroy Solidarity in Poland. And it was a Soviet decision; it was planned by them. You know this, Mr. Chairman, as well as do I. The decrees were printed in Russia. The Monday after martial law was declared, there was published a list of some 43 members of Solidarity who had been arrested, 3 of whom happened to be in Washington at the time. Of course, this meant that there had been a list drawn up well in advance of who was to be arrested—that type of thing.

It seemed to me when I wrote this piece that their expectation would be that we would make very loud noises about this. We would be furious. We would be angry. We would make new assertions. We might even have a spectacular international television program. But quietly, silently, we would continue to ship our surpluses. We would continue to protect our banks. We would continue to extend credits because our system does not leave us a choice, any more than the President had any choice but to see that Caterpillar got its contract to sell pipelaying machines.

COMMODITY CREDIT CORPORATION DECISION

And that was what was so disturbing about the Commodity Credit Corporation decision to pay Poland's overdue debts to American banks without a declaration of default. It was arguably an illegal decision; it was certainly, Mr. Chairman, a secret decision. Yet, it was done. Mr. William Safire of the New York Times deserves a great deal of credit for having found out about it. The Wall Street Journal this morning reports that until now, a part of any written loan guarantee agreement was that, if the loan is not repaid, the Commodity Credit Corporation would repay it. But a condition that had to be fulfilled before such payment could be made is for the banking institution that extended the loan to say that the loan is in default.

That has always been the rule. And it has also been the rule that if you were to change it you would have to publish the change in the Federal Register.

Now I know it is necessary each year at budget time to report how many fewer pages of the Federal Register have appeared in the previous year, but half a page would not ruin even this administration, dedicated as it is to trimming the Federal budget. But they didn't do that.

That's my first point, Mr. Chairman. We have acted precisely according to the pattern that was expected by the planner, you might say, in Moscow.

ASPECTS OF DEFAULT

The second point, Mr. Chairman, is simply to say that default is not a drastic assertion. It is simply a declaration by a lender that a borrower has not fulfilled one or more of the conditions agreed to when the money was borrowed. It is a routine declaration and is provided for in these loans.

And with respect to the question of what happens in the aftermath of default, is there any absolving of responsibility, the answer, sir, is none. I offer you the judgment that a loan made—this is not a judgment; this is law, international law—a loan made to a government remains a responsibility of that state regardless of the succession of governments. It is for this reason that we are still trying to have loans to Czarist Russia repaid by the Soviet Union and loans to Sun Yat Sen paid by the Peoples Republic of China.

STATE RESPONSIBILITY FOR LOAN

The state is responsible for the loan, and as long as the state exists the loan is outstanding and collectable. It does not have anything to do with what the governments are or anything else.

If a miller in Wisconsin failed to pay a grain merchant and the grain merchant went to the CCC to collect the guaranteed loan, would not that miller be declared in default? Of course he would.

That is central to loan guarantee agreements, the assertion that we are not going to give the money to you until you say the loan is in default. Should we have a double standard? Should we treat our own people with less consideration than the totalitarian governments of the East? I don't think so, sir. I don't think you think so.

I want to thank you for holding these hearings. I have spoken longer than I intended. I would answer any questions that you might put to me.

EAST-WEST TRADE ADVANTAGES

Senator KASTEN. I appreciate your joining us this morning, and I appreciate your testimony. One of the points that I would like for you to comment on, because of your experiences—I particularly discussed this with Dr. Fred Ikle of the Department of Defense—was that we began with the concept that East-West trade was going to help the West, and that Eastern European countries would gradually become more and more dependent upon us. This would "bind the East to the West with hoops of gold," I think we at one point said.

And it appears today that the result is exactly the opposite of what we wanted. We have ended up in a position where threats to cut off aid or credit, or threats to cut off sales or shipments of machinery and plant equipment no longer carries any credibility. We have, in fact, found ourselves in the position where we now have a lack of flexibility, and that we are in a difficult position in terms of establishing any credibility.

You suggested in your statement that the credibility problem is one that we have, but I wonder if you could comment on the East-West trade question.

Senator MOYNIHAN. Yes, Mr. Chairman. I was in the White House at the time that this doctrine was being developed. I noticed it. Part of the notion of détente was that by establishing a dense economic relationship, a dependency would arise, and that the totalitarian countries would get used to the arrangement and would be very reluctant to jeopardize it.

GOLDEN HOOPS THEORY OF DÉTENTE

What is one to say about this trade policy? I think George Orwell said it once—in 1943, when American troops began arriving in England and the word went around Bloomsberry that they were coming not to start a second front, but to put down an incipient general strike. Orwell wrote: "You know, you have to have gone to college to believe that. Any taxi driver could tell you it wasn't so."

Similarly, you had to have gone to college to appreciate the golden hoops theory of détente, to have persuaded yourself that totalitarian governments behave like democratic governments, and that they wouldn't dare cut off the butter supply. That the totalitarians wouldn't dare raise the unemployment rate in Peoria. They wouldn't dare go into Iowa before the caucus season and say I am for maintaining an embargo of the previous President.

How do you suppose they have continued? The most dangerous situation in the world has been the Soviet military buildup over the last 20 years. It is, as Secretary Weinberger said, as Dr. Ikle told you, without equal in history and it has been done on the back of a sick economy that has survived by these infusions of foreign credit, because they don't have elections, because they don't publish unemployment rates. And they have not hesitated to use the power of the strike to stay in power. If they can control opinion they can control suffering and they can compose a great deal of it.

RESPONSE ACTION BY WESTERN NATIONS

We in our democratic society can't and don't. We respond to general discomfort and particular complaints, and that should have been evident from the first moment. Any taxi driver could have told you that an American President is going to have a lot harder time cutting off wheat exports to the Soviet Union than the head of the Soviet Union is going to have doing without them.

At the very least, sir, we can be consistent in the appreciation of our own standards and not treat leaders in a totalitarian nation any better than we treat our own people.

It seems to me hopeless to say we should have no relations, no economic relations. But they did solemnly sign an agreement at Helsinki. Recall that the whole notion of the hoops of gold was part of the Helsinki ambience. They solemnly signed the final declaration of the Helsinki Conference on Security and Cooperation in Europe, which included the third basket on human rights. They have brazenly and utterly violated that solemn treaty commitment, for which they won in return diplomatic recognition of the ceasefire lines of 1945.

That was a peace conference—Helsinki—and they are breaking it openly. When we don't do anything we invite their contempt. Mr. Chairman, they are contemptuous of people who put on television shows declaring their anti-communism and silently paying off the loans because they've got to ship the goods and make the money. And if you want to get in trouble in the world there is no quicker way than to invite the contempt of an armed military dictatorship.

Senator KASTEN. Thank you for your testimony, and I thank you for joining us.

ADDITIONAL INFORMATION

This concludes the hearing today. I would like to thank the witnesses. Without objection, extraneous material, including several newspaper reports, will be included in the record.

[The information follows:]

THE WALL STREET JOURNAL, THURSDAY, JANUARY 7, 1982

Officials Argue U.S. Role on Polish Debt

By Steve Lipsky

WASHINGTON—On December 17, four days after the Communist crackdown in Poland, Secretary of State Haig received what's called an action memo. It was sent by his assistant for business and economic affairs, Robert Hormats, and the head of his European bureau, Lawrence Eagleburger. The subject was "Western Economic Leverage on Poland." The memo's recommended action was that Secretary Haig place a phone call to his counterpart at the Treasury, Donald Regan, and the memo included some "talking points"—in effect, a mini-script—that Mr. Haig might use.

"As you know," the memo suggested Mr. Haig might say to Mr. Regan, "the private banks will be making a decision soon on how they will deal with their Polish debt restructuring. The situation between the U.S. banks and the Poles is very tense. It is an eyeball to eyeball negotiation." The memo suggested Secretary Haig might want to point out that the banks "wish to force the opening of the Soviet umbrella if they can"—that is, force Moscow to bail out the Polish debts. The memo noted Mr. Haig might want to say he had no problem with this "although we may not like the type of political and economic conditionality the Soviets may put on such a loan to Poland."

Then the memo noted Mr. Haig might want to say he is concerned if a payment from the Poles isn't forthcoming. It suggested he tell the Treasury Secretary that the State Department prefers the banks "continue to negotiate this issue rather than break off discussions and call a default." The memo suggested he might want to say: "We believe our economic leverage on the Poles is maximized if they must contend with meeting their Western debt obligations. . . . If you agree, I would hope that you could call senior U.S. banking officials to convey this message."

Second Thoughts

On the following day, Mr. Hormats sent Mr. Haig a "quick update" on Poland. This time he said that "after reflecting on the memo Larry Eagleburger and I sent you yesterday, I have concluded that the best course of action with the banks is simply to say nothing to them on the question of rescheduling. While I originally thought that a rescheduling would keep the Poles' 'feet to the fire' with respect to the debt, I am now convinced that it would probably send the wrong political signal, particularly if it were seen that we were even indirectly encouraging the banks to do it."

So, apparently, ended the Hormats-Eagleburger venture into international banking. But beneath such State Department floundering are the stirrings of an important debate within the administration. The debate centers on the implications of the massive Western credits that are now out not only to Poland but to other parts of the Soviet bloc. And it centers on a growing recognition that while such credits expose Western banks and governments to enormous financial risk, they also provide the West with potentially important leverage.

Indeed, other officials within the government are arguing that debt rescheduling is the most important lever the U.S. has in trying to force the Polish government to back off from its repressive politics. It is, these officials are arguing, also the most effective lever the U.S. has on the Soviets: If the West refuses to reschedule Polish debt, then the Kremlin's treasurers, already scraping for hard currency, could be forced to step in to pay the Polish bill. The officials apparently are arguing that the administration should weigh how it plays the debt card, but that when the time comes it should play it.

An important debate stirring within the administration centers on the implications of the massive Western credits now out not only to Poland, but to the Soviet bloc.

It's difficult to judge just how far these arguments are being taken within the government. But some aides have gone so far as to sketch out a set of options under which the Reagan administration could take action on the share of Poland's debt that the U.S. government holds directly. Payments on such debt due in 1981 have already been rescheduled, and preliminary talks have been held on rescheduling amounts coming due in 1982. It's here that the hawks on the debt issue reckon the administration could move to apply its leverage.

One option would be to defer rescheduling, without mentioning conditions—or with mentioning only vague conditions—for resumption of negotiations. A second would be to threaten not to reschedule Poland's foreign debt unless specific conditions are met, such as the release of political prisoners, restoration of Solidarity's rights and guaranteed freedom of expression and communication for religious groups. A third option would be to declare Poland in default on its debt service.

To appreciate the impact of this, consider one picture of Poland's financial bind for 1982, as sketched by U.S. government analysts. The country probably needs $9.2 billion in foreign credits this year, just to meet external obligations and keep its economy moving in lackluster fashion. It would hope to obtain $3.8 billion through rescheduling official debt to Western governments and $2.9 billion by rewriting agreements with Western private banks. It would then need $2.1 billion in new Western credits. It would be lucky if it could earn a trade surplus of $500 million to pay the rest.

Such a plan would presumably turn to ashes were the Reagan administration to refuse to participate in rescheduling the funds—between $700 million and $900 million—it is owed in 1982. If the U.S. declared a default, things would be more difficult still. At a time when Poland would want not only deferrals but new loans, it would find lenders instead lining up with lawyers trying to seize Polish assets in court. Such events could even make it more difficult for other Eastern European member nations of Moscow's Council for Mutual Economic Assistance to raise the sort of credit they need to underwrite their own development programs.

Clearly such a plan would be most effective were it to be taken by all Western creditor nations at once. This is unlikely. But some in the government are arguing that even without Western unity, a firm unilateral U.S. position not to reschedule would put severe pressure on Western governments to follow suit. This is because they would have to reschedule more of their debt to counter the U.S. action, in effect, helping to pay Poland's debt to Washington.

Moreover, a savvy administration could move to soften the blow on its allies. For example, it is being argued that the administration could offer allied governments a quid-pro-quo—that the U.S. would assist in insuring the continuing smooth functioning of the international financial system. West Germany would be hit the hardest, as its banks are owed about $2.65 billion by the Poles. The U.S. could back Bonn by activating lines of credit between the U.S. Federal Reserve and the West German Bundesbank.

Some planners are arguing that potential disruption to the international banking system from a possible default could be forestalled by a kind of distant early warning. This already is coming through the press coverage in recent months of the

whole Polish debt mess, which has put on alert any creditors not already preparing themselves for possible defaults. But, some are arguing, there could also be a joint public statement by high-level allied finance ministers to the effect that national governments stand ready to preserve the soundness of their banks and would coordinate efforts to insure the smooth functioning of the international financial system.

President Soft-Pedaled the Issue

So far, the Reagan administration has refrained from moving for a default on the Polish debt. The President, in announcing his economic sanctions against the Poles and the Soviets, barely mentioned the existence of Western debt, let alone the fact that the Poles can't pay. The International Monetary Fund wasn't mentioned either, though bureaucrats there are processing Poland's application for IMF membership as though nothing had happened December 13. The IMF had received hardly a frown from the Reagan administration, at least publicly, though the White House is halting other forms of aid. Commercial bankers, some seeming actually pleased at the crackdown, are hoping to sign a formal rescheduling accord with Warsaw if they get their interest payments.

How will this debate come out? At year end, Assistant Secretary of State Eagleburger's office was still shying away from any stern action on debt. For example, in a December 31 memo to Undersecretary of State Walter Stoessel Jr., Mr. Eagleburger argued against invoking a clause in the 1981 rescheduling agreement that would have allowed the U.S. to unravel the pact because of "exceptional circumstances." He argued that such a default would do little damage to Poland and could relieve Warsaw of obligations to make the few debt repayments it's now responsible for.

President Reagan, however, has publicly warned the Soviet Union that if the crackdown isn't eased in Poland he'll take further action. The government is considering such things as withdrawing an export license, issued in November, which allows International Harvester to supply Moscow with a $300 million plant to make agricultural machinery. A number of thinkers within, and outside, the government are convinced that such a gradual escalation won't be effective. And they are contending that if the administration really wants to get serious about forcing the Kremlin off its course in Poland, it's going to have to put its money where its mouth is.

Mr. Lipsky is an associate editor of the Journal's editorial page.

THE WALL STREET JOURNAL, FRIDAY, JANUARY 8, 1982

The Consequences of Polish-Soviet Trade

By Zygmunt Nagorski

Reports from the military junta in Warsaw indicate that trials soon will be held of former high Communist Party officials responsible for the country's economic disaster; many will be charged with corruption, others with incompetence. But the trials will almost certainly spare from public accusation the main culprit — the Soviet Union.

Among the luxury items the Solidarity period in Poland brought to that unhappy country was freedom of disclosure. There were so many disclosures of public documents revealing the manner in which previous governments had run Poland that some important information went unnoticed. One such disclosure suggested the extent to which the Soviet Union carried the principal blame for the gradual decline of Poland's economic welfare and for the dramatic growth of Polish indebtedness to the West. At a relatively minor gathering of provincial party officials last spring, a document was presented by a party member describing the economic consequences of the trade policies the Soviets imposed on Poland over the last five years.

In 1976, according to the document, Russian leaders convinced their Polish counterparts that it would be in their mutual interest to transact trade in a specially created accounting system and that the Russians should be permitted, and even encouraged, to purchase from Poland finished and semi-finished products in exchange for raw materials.

Limited-Use Ruble

The trade agreement's unit of exchange was described as a transferrable ruble, which is the term often used to describe the unit used to settle trade accounts among the Comecon partners. But this system seems to have been uniquely developed between Poland and the Soviet Union. Poland's debts to other members of the Soviet bloc could not be paid in this monetary unit, nor could it be used to accumulate monetary reserves. In short, in spite of its official label, the new unit of payment introduced as the only permissible one in 1976 was neither transferrable nor liquid.

It allowed the Soviet Union to bypass the problem of hard currency. Using hard currency received in loans from the West, Poland would purchase licenses, some raw materials, semi-finished products and food from Western suppliers. Poland was then asked to sell a wide range of finished products to the Soviet Union.

For bookkeeping purposes, the value of a dollar for these transactions was set at 67 kopecks, and later 62 kopecks, even below the official level of the regular Soviet ruble. The Poles calculated in the party meeting document that the Soviet Union was making a clear profit of about 30% on each dollar transacted. Poland, which paid in dollars to the West, was the loser.

During the party meeting at which the disclosure of this agreement was made, one speaker drew a daring conclusion: Poland's high indebtedness to the West was in direct proportion to the volume of Poland's trade with the Soviet Union.

To check on the validity of this assumption, it is necessary to look back. The new system was introduced roughly five years ago. Until 1976, Poland's indebtedness to the West amounted to $3.8 billion, in spite of the fact that the first five years of the decade saw tremendous industrial growth and a high level of investments in heavy industry. Today's debts amount to over $27 billion.

Poland's trade balance with the Soviet Union was on the positive side and on an average, Poles were able to accumulate around $3 billion annually in their hard currency reserves. They also had at that time a fairly solid credit rating in the West. Until then, all the Soviet-Polish trade was conducted through clearings. Goods sold to Russia were calculated on the current value of the dollar; the same principle was applied to Soviet goods sold to Poland and then the entire transaction was recalculated in rubles. Poles were losing a little due to the inflated value of the ruble but it was the least they could expect. Once the system was changed in 1976, the entire picture of trade with the Soviet Union changed.

'The reasons for the present crisis are rooted in the unjust and unfair conditions of our foreign trade, conditions which can be described as robbing Poland of its hard-currency reserves.'

"The reasons for the present crisis," the party meeting document states, "are rooted in the unjust and unfair conditions of our foreign trade, conditions which can be described as robbing Poland of its hard currency reserves." In addition to depriving Poland of its hard-won currency and forcing it into further debt to the West, the system made the Polish market an extremely attractive hunting ground for official Soviet buyers.

Scores visited Poland from 1976 onward. Inhabitants of Warsaw recalled endless television coverage about arrivals and departures of Soviet dignitaries: ministers, directors of industrial sectors from Soviet Asiatic republics and others. Shortly thereafter, a connection was observed between sudden shortages of goods and products and the direct, professional interests of the departed visitors.

After the Soviet minister of energy left, coal was not readily available on the market; power plants began receiving lower quality coal, reducing productivity by 15% to 17%. A visit by the minister of chemical industry resulted in a shortage of chemical fertilizers. Drugs were in short supply after a huge order was placed by the visiting Soviet minister of health. The most damaging of these visits was that of the man in charge of the Soviet agricultural sector. From then on, Poland became an active exporter of grains and meat to the Soviet Union.

Even without official visits, the document says, the Soviet Union increased its role as a trading partner of Poland in a number of other sectors. Moscow became the largest importer of Polish power stations and high voltage equipment; it tripled its purchases of mining machinery; it increased considerably imports of railroad cars and locomotives. Today, the USSR is the largest importer of Polish telephones and communication equipment. Five million units of telephone receivers were exported from Poland to the Soviet Union in 1978 alone. Altogether, according to the official Polish statistics in 1978, exports of industrial machines and equipment increased by over 30% from the preceding year. The list, presented at the provincial party meeting, is far from complete.

Airplane engines, computers, shipbuilding machinery and armament factories have also been listed as heavily oriented toward Soviet export markets. All these finished goods called for heavy injections of high technology, spare parts and other items obtainable in the West only for hard currency.

The document also cites the remarks of a top Polish government official on the high level of industrial activity needed to fulfill Soviet requirements: "According to the declaration of Minister Marian Krzak (currently minister of finance), published in Dziennik Baltycki (The Baltic Daily, No. 75, 1981), in order to secure the necessary production to fulfill export needs it would have been necessary in 1981 to secure an additional loan from the West of $11 billion."

An indirect reference to that state of Soviet-Polish trade appeared in a statement two days ago from Moscow and reported over Warsaw radio regarding new Soviet loans to be granted to Poland. There will be a decline in exports of capital goods from the Soviet Union and considerably lower exports from Poland to Russia due to economic conditions in Poland. The announcement also added that the USSR, due to a lack of hard currency in Poland, will assume the role of sole supplier of oil, natural gas, pig iron and saw timber. It is

worth remembering that in the past the Soviet Union exported to Poland about 9 million tons of iron ore and 13 million tons of oil annually.

The attractiveness of the Polish trade to the Soviet Union under the new arrangements is clearly illustrated by the degree that Soviet-Polish trade grew over the years. The last three five-year plans between the two countries can be taken as indicative. According to statistics cited in the party meeting document during the first of these, 1966-70, the volume of trade grew by 8.2%; during the second, 1971-75, still operating on the principle of clearances, the growth amounted to 17%. In the last five-year period, 1976-80, the increase was 22%. Considering that Polish productivity increased during that last period by 5.8%, the gap between productivity and export requirements can be easily understood.

The Roots of Solidarity

That gap also explains shortages in Poland of food and industrial goods. In 1980, only 4% of industrial production was earmarked for the agricultural sector and even that meager share was not delivered. Exports to the Soviet Union drained domestic Polish markets, contributed heavily to the Polish indebtedness to the West and indirectly must have been responsible for the initial economic upheavals among Polish workers. These upheavals led eventually to the birth, success and ultimate temporary demise of the Solidarity movement.

The Polish economic crisis cannot be fully attributed to the Soviet export exploitation. But judging from the facts and figures as they emerged during the liberalization period in Poland, and never challenged by either Soviet or Polish officials, it was a considerable factor. Conventional wisdom often voiced in the West that the Soviet Union has a vested interest in seeing Poland afloat is only partly correct. Poland, as it emerged from the above analysis, has been an excellent conduit of goods and services that the Soviet Union would have had to buy outside the Eastern bloc for hard currency. Instead, Poland paid the bill. It was Poland that earned itself a poor credit rating, and it was Poland that attempted to free itself from both export requirements and other forms of Soviet direct and indirect pressures and paid the ultimate price.

It has been reported that the Soviet Union has "helped" Poland in paying part of its interest due to the West. The Soviet Union should also seriously consider contributing a major part of the principal of the Polish debt.

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Wall Street Journal

REVIEW & OUTLOOK

The Issue in Poland

Yesterday our Seth Lipsky disclosed documents showing that in the wake of the Polish crackdown, the State Department's first instinct was to urge the banks to go easy in their negotiations on debt rescheduling. While State's economic wizards later thought better of such lunacy, it remains clear that no one in charge has picked up a clue that in Poland the debts are *the* issue.

We do not mean to denigrate the human rights implications of the Polish tragedy, nor the political lesson of yet another demonstration of the inability of communism to either tolerate or totally suppress freedom and diversity. But from the standpoint of U.S. national interests, the Polish economic crisis and its impact on Western debts has an even more portentous aspect. It is the first eruption of an issue transcending Poland and going to the heart of Soviet-American relations. To put the issue in its most dramatic form, it is this: Are we going to continue to allow and even encourage Western banks to finance the Soviet military machine?

How does this come about? For starters, it is useful to think of Poland

Soviet Bloc Debt
(Net hard-currency debt to the West in billion current U.S. dollars)

	1970	1980	1985-f
Bulgaria	0.7	2.7	4-5
Czechoslovakia	0.6	3.4	5-6
East Germany	1.4	11.8	18-20
Hungary	0.6	7.0	10-11
Poland	1.1	11.9	31-35
Romania	1.6	9.0	19-21
USSR	1.0	9.6	30-35
Comecon Banks	0.3	4.1	6-7
Soviet Bloc Total	7.3	60.5	123-140

Source: Wharton Econometric Forecasting Associates.
f-Wharton forecast.

the way Leonid Brezhnev thinks of Poland—and indeed all other members of Comecon—as a Soviet vassal state. As Mr. Nagorski reveals elsewhere on this page today, the Soviet Union in 1976 created a "transferrable ruble" to, in effect, obtain a highly favorable exchange rate from its Comecon partners and thus buy manufactured goods cheaply. To provide these goods, the satellites were encouraged to borrow heavily in the West to buy machinery, raw materials and semi-finished manufactures. Western bankers and businessmen were thrilled with the new "vitality" in the East, an illusion that caused them to allow the hard currency debts of the East Europeans to rise out of all proportion to their ability to repay (see tables).

In simplest terms, the Soviet Union exploited its Comecon partners as a conduit to obtain Western goods on the cuff. As the Wharton tables show, Soviet hard currency debt has itself expanded sharply and is expected to rise further in the years ahead, but it is not yet nearly as far out of line with any prudent measure of repayment ability as the debts of Poland, Hungary and East Germany. The Russians got the TV sets and Wartburgs and the Poles, East Germans and Hungarians received the bills.

The Soviets got by with this by literally holding guns to the heads of satellite party leaders; Soviet troops and tanks ring Prague and Budapest, heavily occupy East Germany and surround Poland. What the Russians didn't foresee was that East European workers, first of all the Poles, would grow tired of having the fruits of their labors purloined. Without doubt, the absence of goods to buy with zlotys contributed to the Polish uprising.

The Soviet exploitation of Western credit markets and East European workers has had the primary purpose of enabling the Soviets to build and maintain a vast military establishment. The primary role of that establishment is to intimidate the Western European suppliers of goods and credit and absolutely control the Eastern European suppliers of labor. To this end the Soviets spend some 15% of their total GNP for military purposes, more than twice the percentage for the U.S. They have some 3.7 million troops in uniform, 3,300 combat aircraft, 55,000 tanks and a grand array of other lethal equipment. The officers of this force are part of the Soviet elite, highly pampered in a society where ordinary people suffer severe deprivation.

In short, the economies of Eastern Europe are organized to support the economy of the Soviet Union, and the economy of the Soviet Union is organized to support its military machine. Into this process the Western banks have pumped some $60 billion in the last decade. If the forecasts by Wharton Econometrics prove true, they will pump almost this amount again into the same process over the years of the Reagan administration.

Indeed, with the breakdown of the Comecon credit pipeline and another big failure down on the collective farms, the Soviet Union has had to go directly to the West for money. The Bank for International Settlements estimates that the Soviets borrowed over $15 billion in hard currency last year. Reports from Europe yesterday suggest this borrowing is continuing (see page 2 of the Journal). And Soviet gold sales in the West more than tripled to 250 metric tons in 1981, according to London market estimates.

Despite all these circumstances, Western politicians are in their usual dither, insisting that there is nothing much they can do about the Russians' ham-fisted crackdown on the Polish workers. Quite clearly there is a great deal to do, and it is in the interest of the West to do it.

Ironically, the simplest thing the U.S. government could do would be to ask the banks to face the real risks of these loans. A significant, modest and entirely justified step would be for the Comptroller of the Currency to suggest banks take a 50% write-down on loans to Poland, and perhaps Hungary and East Germany. Bank regulatory officials in other Western countries could be encouraged to take parallel action. This would immediately raise the cost of credit to the whole Soviet bloc.

The credit-worthiness of the Soviet Union itself is endangered by the Comecon debts, for its own economy is dependent on theirs in many ways. If it undertakes to provide the umbrella the banks have hoped for, its own resources will be stretched. Wharton Econometrics has not calculated a debt service ratio for the bloc as a whole; an analyst there captures the attitude of the banks by saying they would find such a figure "meaningless." But the OECD, which uses a more stringent debt-ratio calculation, puts the bloc at 0.4, including the Soviet Union. Some umbrella.

Beyond that, there is the definite risk that over the next few years the

Debt Service Ratios
(0.2 or higher regarded as a danger signal in international lending)

	1970	1975	1981-f
Bulgaria	0.30	0.44	0.29
Czechoslovakia	0.09	0.11	0.25
East Germany	0.14	0.26	0.43
Hungary	0.16	0.24	0.57
Poland	0.19	0.32	0.87
Romania	0.36	0.21	0.32
USSR	0.07	0.13	0.07

Source: Wharton Econometric Forecasting Associates.
Debt Service ratio is the ratio of debt service (interest plus repayments) to sum of hard currency export balance and net balance in invisibles.
f-Wharton Forecast.

Soviet workforce itself will go Polish. The Soviet Union's resources are becoming ever more strained. Its inefficient use of manpower, a product of central planning and regimentation, coupled with a low birth rate, has severely stretched the manpower supply. Productivity and morale are low, owing in part to the fact that Soviet workers fare no better than the Poles at the hands of the Communist elite. Alcoholism is epidemic. The Red Army's inability to subdue Afghanistan is requiring larger infusions of troops.

In this lies the West's great foreign policy opportunity. The future of the Soviet economic system depends on access to the Western banking system. Instead of encouraging the banks to roll over debt in the wake of Poland, the government ought to be making clear that this access depends on a modicum of Soviet good behavior. By any realistic risk assessment, indeed, it is military spending and repression of Eastern Europe that call its credit standing into doubt. To price the Soviets out of the credit markets, what the government chiefly has to do is bring the lenders face to face with economic reality.

We Cannot Create a 'Municipal Assistance Corporation' for Poland. Let It Go Bankrupt.

By Felix G. Rohatyn

When New York City teetered on the brink of insolvency in 1975 — as Poland has been doing for months — many conservatives advocated that the city declare bankruptcy to symbolize the bankruptcy of liberalism carried to extremes. The symbolic lesson, however, would have been devastating to both the city and New York State.

That argument was successfully fought down, and the city was brought back to health with the imposition from outside of severe budgetary controls, and later by a growing economy.

A much stronger argument can be made that Poland should be declared bankrupt.

Poland owes more than $25 billion to Western banks and governments. The $3.8 billion credit recently announced by the Soviet Union does not address this issue: It is purely a bilateral-trade credit.

Poland is not only incapable of paying back any of the principal on its debt to the West but also may be able to meet its interest payments only with Soviet assistance. The technical arguments about whether to declare Poland in default are pure "theology" — in fact, Poland has been in default for some time.

The real question about Polish credits is not whether to roll over the debt. Rather, there are two other questions: Who will lend Poland the further $20 billion to $30 billion of additional capital it may require? And who will impose the harsh economic discipline that might be needed to put the country back on its feet economically? The answers will determine whether any of the present debt can ever be collected.

Poland, which is now in social shambles, has been in economic shambles for years. The level of austerity and sacrifice that would have to be imposed on Poland as part of any new credits would be drastic; many, if not all, of the economic gains Solidarity made might have to be rolled back, and the life of the Polish people might be very much harsher than in recent years.

One has only to think back to the United States' loans of the 1920's, which were set up to refinance post-World War I reparation payments that the German nation could not afford, to see the danger of a nation's turning against its creditors.

No Western institution, either bank or government, should lead such an effort; no international institution, such as the International Monetary Fund, should do so.

The Soviet Union exercises political and military control over Poland, so the Soviet Union should take the burden of financing Poland together with the blame that may be attached to the resulting social and economic conditions.

The only alternative would be an enormous program of outright grants, in the tens of billions of dollars, to the Polish Government.

The West has tacitly acknowledged that we have neither the influence nor the power to improve the lot of the Polish people; grants to Poland would help maintain a repressive Government and save the Soviet Union the expense. Therefore, if grants are the answer to Poland's credit problems, they also should be the burden of the Soviet Union.

It is to the clear advantage of the West to put the burden of the Polish economy squarely on the Soviet Union. It is also to our advantage to emphasize the economic bankruptcy of Communism by declaring Poland a bankrupt.

Détente does not require that large gifts be made to the Communist world. Loans that are not susceptible to collection become gifts.

The loans to Poland do not stand alone. Rumania has borrowed about $10 billion from the West and is currently negotiating payment deferrals. Hungary has borrowed more than $7 billion. The Communist world's total borrowings from the West are estimated at about $80 billion.

At the peak of the Marshall Plan for Europe, the United States advanced about $15 billion to Western Europe, all or most of which ultimately was repaid. Even taking inflation into account, Western credits to the Communist world far exceed comparable credits under the Marshall Plan, with less prospect for repayment and clearly no prospect for the kind of economic and political partnership that the United States found in Europe as a result.

If the West does not refinance the Communist world, the Soviet Union will have to do it. That may be why the Soviet Union has recently sold very large amounts of gold. The Soviet Union should be required to refinance not only Poland but all of the satellite countries: The benefits of conquest should carry the burdens of support.

The West German Foreign Minister, Hans Dietrich-Genscher, recently suggested large additional Western credits for Poland in exchange for commitments to political reform. Poland is unable to keep such commitments; only the Soviet Union can do so. If the Soviet Union wishes for Western participation in the financing of its satellites, we should, of course, consider that desire in the context of outstanding issues between ourselves and the Soviet Union.

The Western banking system is in fragile condition, but it will not come tumbling down with a bankruptcy of Poland, although such a bankruptcy would entail unquestionable risk and should be handled with care.

Private banks hold probably no more than 50 percent of Poland's credits, with governments holding the balance. Many West German banks and their shareholders would suffer considerable losses. Some United States banks would take writeoffs that they would prefer to avoid. But central banks could see to it that no individual bank got into real liquidity problems.

Clearly, the bankruptcy of Poland would carry considerable costs, but the costs of the alternative would ultimately be greater.

Over this decade, capital is going to be in short supply throughout the world, except perhaps among a few members of the Organization of Petroleum Exporting Countries. In our constant competitive struggle with the Soviet Union, capital can be as potent a weapon as intercontinental ballistic missiles. Why should the West supply the Soviet Union with such a weapon?

The capital requirements of Soviet satellite countries, together with the domestic requirements of the Soviet people, will be very difficult for the Kremlin to meet because of the poor performance of the Communist economies. This might cause a change in Soviet attitudes in other fields and, say, could lead to progress on significant reductions in armaments.

It is easy for the Soviet Union to get around a grain embargo, for Argentina and other countries will be glad to accomodate. Trade and economic sanctions are hard to impose since many European countries choose not to follow. The withholding of capital is a different issue, however.

The United States can declare the Polish debt in default and refuse to participate in new refinancing plans; the same goes for Rumania's debts and those of other satellites. The European banks would have to follow suit or assume the burden of all of the debt themselves, but they do not have the capacity to assume such a burden.

The West has been relieving the Soviet Union of what may be its greatest shortage — capital — at the cost of making bad loans while pretending to oppose Communism. That is bad business, bad policy, bad morality.

We cannot create a Municipal Assistance Corporation for Poland to refinance Polish debts or an Emergency Financial Control Board to see to their repayment. We should, however, go beyond relatively meaningless acts of retaliation and rhetorical expressions of support for the Polish people.

We should put the economic burden of the satellite states squarely on the Soviet Union and point up the bankruptcy of the Communist system by declaring bankrupt one of its largest units.

When the economic burdens grow sufficiently heavy, the Soviet Union may become more accommodating and, together with the United States, may find it in its self-interest to reduce drastically defense budgets that neither country can really afford.

The weapon of capital is potentially one of the most powerful and least used in the Western world. Poland affords us a chance to use it. It might turn out to be our only effective way, in the long run, of bringing about change behind the Iron Curtain.

Felix G. Rohatyn, a senior partner of the investment-banking firm of Lazard Frères, is chairman of the Municipal Assistance Corporation.

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THE WALL STREET JOURNAL, FRIDAY, JANUARY 15, 1982

Soviet Subsidies to Eastern Economies

By Jan Vanous and Michael Marrese

It is now being argued that the Soviet Union has been economically exploiting its trade partners in the Council for Mutual Economic Assistance (Comecon), particularly Poland, by using the "transferable ruble" to obtain highly favorable ruble/dollar exchange rates. In this way, it is argued, the Soviet Union is able to buy manufactured goods from its East European partners cheaply, while Eastern Europe must supposedly borrow heavily in the West to buy the machinery and material used to produce these manufactured goods. And this Soviet exploitation of East European workers and Western credit markets is said to have been used to allow the Soviets to build and maintain a vast military establishment.

The problem with the theory is that its key premise—that the Soviet Union exploits Eastern Europe through the imposition of discriminatory terms of trade—is not supported by the facts. A recent study prepared by the authors, soon to be published by the University of California Press at Berkeley, concluded that in recent years the Soviet Union has granted Eastern Europe large trade subsidies, averaging $5.8 billion during 1974-78, rising to $10.4 billion in 1979, and a staggering $21.7 billion in 1980.

Similarly, in a report before the Joint Economic Committee presented last July 8, Maj. Gen. Richard X. Larkin, deputy director of the Defense Intelligence Agency, and Edward M. Collins, vice director for foreign intelligence, said that "Soviet aid of all kinds to other Communist regimes rose from nearly $2 billion in 1971 to nearly $24 billion in 1980." In view of the empirical failure of the "exploitationist" description of Soviet policy in Poland and the rest of Eastern Europe, we are forced to look for other explanations.

The most likely motivation for a Soviet policy of economic subsidization of Eastern Europe is to obtain military, political, and ideological benefits from the Communist parties of East European countries.

Our estimate of the distribution of Soviet trade subsidies among individual East European countries is presented in the accompanying table.

What gives rise to these subsidies? Their primary source is the price formation formula used by the Comecon countries for intra-bloc trade. Since 1975, intra-Comecon prices have been set on the basis of a lagged five-year moving average of dollar world market prices converted to rubles. For example, the Soviet export price for oil in 1980 was based on the average of world market prices during 1975-79.

Over the last decade, world market prices of energy and primary goods have been growing much faster than prices of manufactured goods. Since the Soviet Union primarily exports fuels and non-food raw materials to Eastern Europe and imports manufactured goods, the intra-Comecon price formation formula has not worked in its favor. In other words, thoughout the decade, the Soviet Union would have been better off economically if it had been able to divert its exports of energy and raw materials from Eastern Europe to the West and purchase the manufactures it needs from the West rather than from Eastern Europe.

To illustrate how Soviet Union subsidizes its trade with Eastern Europe, we'll use some examples from Polish-Soviet trade. Three key Polish import commodities, which represent 31% of Polish imports from the Soviet Union, are crude oil, natural gas and cotton. Three key Polish export commodities, which account for 12% of Polish exports to the Soviet Union, are hard coal, railroad cars and fishing trawlers.

The Soviet Union engages in preferential trade ... to sustain the allegiance of and maintain dominance over Eastern Europe's Communist parties.

Using data from the official Polish foreign trade statistical yearbook for 1980, we compare prices of Polish exports to the Soviet Union and to the West, and prices of Polish imports from the Soviet Union and from the West for each of the above commodities.

At the ruble/dollar exchange rate of 0.65 ruble per dollar, we found that the Polish import price for Soviet crude oil was 52% below the average import price from the West, 26% below the Soviet export price to the West for natural gas and 18% below the average import price from the West for cotton. The Polish export price for hard coal was 25% above the average export price to the West, for railroad cars 12% above and 149% above for fishing trawlers. Hence, unless one argues that the official Polish trade statistics are intentionally distorted by the authorities, for which we have no evidence, we have to conclude that Poland trades with the Soviet Union at terms far superior to these available in the West. It is the Soviet Union that subsidizes the Polish economy.

Moreover during the past two years Poland has received other Soviet economic assistance. In addition to the $6.5 billion in trade subsidies we estimate Poland received from the Soviet Union in 1980-81, it also got $0.8 billion in direct Soviet hard-currency loans, $0.5 billion in Comecon bank loans backed by the Soviet Union and $2.7 billion worth of ruble credits (equivalent to about $2.3 billion at a realistic exchange rate of 1.18 rubles per dollar). Total Soviet economic assistance to Poland, including repayable credits, amounted to an equivalent of $10.1 billion. It is hardly surprising Soviet political leaders have been demanding some political return on their "investment" in Poland.

This brings us to the question of why the Soviet Union is willing to subsidize Eastern Europe. If, as some view it, Eastern Europe is a part of the Soviet "empire," would it not be reasonable to expect that the Soviet Union maintains this empire to exploit it? We argue to the contrary. With respect to trade with Eastern Europe, the Soviet leaders seek, in addition to the conventional gains from trade, certain non-economic benefits that are military, political and ideological.

The Soviet political leadership maintains national security from a combination of Soviet troops and military hardware in the Soviet Union, Soviet troops and military hardware stationed in Eastern Europe and the allegiance of the Communist parties of East European countries. This allegiance can substitute for the direct use of Soviet manpower and hardware to provide security services to the Soviet Union. The Soviet Union is the dominant power within Comecon, and it engages in preferential trade treatment of Eastern Europe relative to the West to sustain the allegiance of and

Soviet Trade Subsidies to East European Countries
(In million current dollars)

Year	Bulgaria	Czechoslovakia	East Germany	Hungary	Poland	Rumania	CMEA Six
1974	1061	1174	1923	877	1067	43	6265
1975	919	1397	1565	598	1027	19	5325
1976	877	1195	1798	671	1021	45	5605
1977	1015	1226	1896	645	1106	50	5938
1978	1087	1086	1914	661	897	109	5754
1979*	2000	2000	3400	1200	1700	100	10400
1980*	4100	4100	7200	2600	3500	200	21700

*Preliminary estimate.

maintain dominance over the Communi parties of Eastern Europe.

In return, the Soviet Union obtains im portant military and strategic benefits: creation and maintenance of the Warsaw Pact military alliance, a buffer of several hundred miles between itself and Western Europe, forward military bases in Eastern Europe and proxy intervention (particularly in the case of East Germany) in Third World countries on behalf of the Soviet Union.

The Soviet Union also obtains political benefits: voting along alliance lines in international forums, informal Eastern European government and media support and, to some extent, even the support and friendship of certain segments of the East European population. Ideological benefits have occurred primarily through acceptance of the Soviet brand of Communist political ideology and its propagation to other countries.

Finally there are also some special economic benefits available to the Soviet Union in return for its trade subsidies: increased economic stability in Comecon, reduced risk of disrupted flow of strategic goods (technologically superior machinery from East Germany and Czechoslovakia) and reduced risk of refusal to purchase Soviet exports for reasons other than their price competitiveness.

The next question is whether Eastern Europe is better off for being associated so closely with the Soviet Union. If the Soviet trade subsidies are viewed as "payment" for the loss of East European sovereignty, the answer is probably no. An independent Eastern Europe, free to restructure its internal and external economic relationships, would probably be far more productive. It is unlikely that the Soviet subsidy makes up for the low productivity of the current system. Moreover, under the conditions of Soviet "hegemony" in Eastern Europe, there is no reason for the Soviet Union to fully compensate East European countries for the loss of sovereignty because of the expected high cost of a popular rebellion in terms of human lives and property.

It is essential that Western policy makers have an accurate understanding of the nature of the economic relationship between Eastern Europe and the Soviet Union in general, and Poland and the Soviet Union in particular. Failure to recognize the extent of Soviet subsidization will only hamper Western efforts to support the Polish people's struggle to overcome their current economic problems and to reduce the degree of Soviet domination over Poland.

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The West Should Not Bail Out Poland

By Stansfield Turner

The President's economic reprisals against the Polish martial law government and the Soviet Union are more signals of intent than punitive actions. What is it in our national interest to do next if the repression of the Polish people does not cease?

There are strong reasons not to press further unless the Soviets actually invade Poland. More stringent economic sanctions would be likely to cause a rift with our European allies; reopen the whole vexing issue of the grain embargo; damage some 60 American banks that hold $11.3 billion of Polish debt; upset humanitarians who want to provide food to the Polish people in their crisis; and bury the thought that if we can keep the Polish economy afloat, democratic tendencies of the Solidarity labor movement may yet survive.

But whatever the merits of these arguments, the overriding consideration that should govern U.S. policy on Poland today is that the Soviets are in such deep trouble that they must subsidize the Polish economy and must prevent a Polish default on debts to the West.

The Soviets cannot let the economy of Poland drop below a humane level. To do so would risk uncontrollable public disorders. In turn, that would force the Soviets to take over the country with military force. They simply cannot afford to lose control of Poland and their military line of communication to East Germany and the border with NATO.

The Soviets have endured much over the past 16 months rather than invade Poland. Clearly they measure the costs of invasion as high. Indeed they would be in terms of a major blow to detente, of reduced trade and credits with the West and of weakened military preparedness vis-a-vis NATO. To the Soviets the costs of continued subsidy of Poland look like a bargain compared with the incalculably larger bill of occupation. At the same time, the Soviets are very resentful of the problems that the Poles are causing them. They will not provide more than the minimal subsidy required to maintain order. Hence, whatever aid we might provide in the name of humanitarianism or long-term political gain will simply have the effect of reducing the Soviets' contribution by a like amount. Our most humanitarian impulses will be thwarted.

If, on the other hand, the Soviets should decide that they positively want to generate an excuse for invading Poland by forcing food riots, no amount of help that we might provide could prevent that. The Polish economy is tied to the Soviet bloc, not to the U.S. and Western Europe.

The Soviets must also try hard not to let Poland default on its debts to the West. Such a default could severely curtail Western lending to the other East European Communist states and even to the Soviet Union. All of those economies are in trouble. All are counting on, and receiving, machinery, technology and spare parts from the West—on credit.

Could the Soviets foot the bill for Poland's debt payments? Of course they could. It would not be easy or pleasant for them (and that is one reason that they have tried so desperately to avoid occupying Poland). They would have to reduce their purchases of grain and technology from the West. They would have to generate more foreign exchange by selling gold, by marketing more oil to the free world rather than consuming it in military operations in Afghanistan or selling it to Eastern Europe for soft currency, and by other feasible, but difficult devices.

Admittedly, there is a risk that without Western credits, the economies of the Soviet bloc will all spiral downward and jeopardize not only the $27 billion of Polish debt the West holds, but the $17 billion of the Soviet Union's and lesser amounts of the other Eastern Europeans'. But how viable are these loans anyway, if the only way to protect them is to make more loans? The loans can be made viable only by fundamental economic reforms in all these countries. That means a greater orientation toward market forces. Because that contravenes Communist political ideology, it can be achieved only under severe economic pressures. The hope, then, for keeping Solidarity's flame alive lies in the Soviets seeing that the economic burden of Poland would be unbearable if they did not compromise with Solidarity to keep the Polish economy afloat. The more we help, the less pressure for such compromise.

Let us not, then, believe that we have either a humanitarian imperative or a political necessity to come to the aid of Poland at this time. The Soviets are over a barrel. It is their problem. Let us not rush to help them solve it.

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THE NEW YORK TIMES, SUNDAY, JANUARY 17, 1982

Poland's Lessons For Mr. Reagan

By Henry A. Kissinger

(342)

Every Administration enters office determined to change the world. Sooner or later — sooner if it is fortunate — it is forced to reconsider its assumptions and procedures. It is the making of the Administration if it is prepared to examine itself seriously and to draw the necessary conclusions. If that test is failed, if energy is expended on rationalizing the status quo, mounting crises and disarray are inevitable.

In that sense, the grace period for the Reagan Administration ended on December 13 when tanks took over the streets in Poland. During the months before the 1980 election, I campaigned for Ronald Reagan, convinced that a change was in the overwhelming national interest. I continue to believe that the Administration embodies the best chance for free peoples, that its success is of vital importance for our country and those who depend on it. And yet it is precisely its friends who have a duty to warn when a crisis like Poland reveals fissures and uncertainties that if long continued may become unmanageable.

It took four weeks after martial law was declared in Poland before the foreign ministers of NATO managed to assemble in council to consider a "response." Thousands of Solidarity leaders were meanwhile shivering in concentration camps; scores of intellectuals had been arrested; strikes had been broken; freedom-loving Poles who looked West saw dithering procrastination, sophisticated justifications for impotence, or rhetoric incapable of rising to serious action. And when the ministers at last met, the alliance expressed regret about Soviet complicity but then responded with a *non sequitur* — that action should be postponed.

The emptiness of the Western reaction to Poland has consequences far beyond the tragedy of the Polish people. It underlines and compounds the disarray of the Western alliance. It symbolizes the lack of consensus on what constitutes security and the near panic in the face of Soviet military power. East-West diplomacy, which should reflect a balance between [illegible] of turning into a safety valve by which the Soviets mitigate the impact of their aggressions. Trade and economic relationships originally conceived as incentives for Soviet restraint are becoming instruments of potential Soviet blackmail used not by us but against us. Today, the West seems clearly less prepared than Moscow is to interrupt these relationships.

It would be some small comfort if this state of affairs could be laid exclusively to European hesitations. Europe's leaders have little to be proud of. But neither have we put forward a clear signal. European fecklessness is becoming an alibi. It is not the sole cause of Western difficulties.

Events in Poland no doubt presented the West with a searing dilemma. We had no military option and it would have been wrong to conduct overselves as if we had. The West has been understandably reluctant to encourage the Polish people into open resistance that we would not then support. On the other hand, statesmen are ultimately judged not by their contemplation of dilemmas but by their ability to conceive alternatives.

From the first day of the repression in Poland, arguments for inaction have cascaded forth — and, if we are truthful with ourselves, not only from Europe. At first we were warned that we must not respond too vigorously or history would blame us if the Polish people decided to resist. It was also said that the West's response should be a measured one in order not to destroy the possibility of eventual tolerance for some diversity held out by the early proclamations of the Polish military Government. Then restraint was urged to remove the incentive for Soviet intervention. Next we heard that our allies must not be driven into neutralism by rash American actions. We must bring them along slowly. In any event, so it was said, Poland had been conceded to the Soviets by the Yalta agreement, which was legitimized by the Helsinki accords.

And now we hear that despite the flagrant violation of the Helsinki accords, all high-level diplomatic contacts must continue and indeed be intensified. The worse the crisis, so the argument runs, the more important such contacts are — even a meeting of the Soviet and American foreign ministers, even a summit conference.

These arguments reflect an odd coalition of extremist views — between those who want to do nothing and those who argue that unless one does everything it is better to do nothing. But, in a deeper sense, we face a conceptual breakdown. Once the Polish Army was unleashed, it should have been clear that Solidarity, as it [illegible] unless some decisive reaction by the West imposed the need for a reconsideration. Communists do not assuage whatever doubts they may have had about the wisdom of a decision by incompetent execution or self-restraint just when the objective is at hand.

All the time-wasting indecision — all the threats of future action unless conditions eased — missed the two principal points. First, time was on the Soviet side. The longer martial law lasted, the more likely was the collapse of resistance; conditions would ease visibly because opposition had been smashed. Second, the only chance of saving anything would have been a Western reaction so immediate, so clear, so beyond rhetoric, so strong — and at the same time leaving open a road for negotiation — as to have given some pause to the Soviet Union and raised some thought of com-

romise. The prospects for this were dmittedly slim; but even these pros-ects vanished completely when the 'est carefully rehearsed reasons why othing should be done and so tacitly, unintentionally, colluded with the artial law. (And sanctions of mar-inal significance — chosen indeed for at very reason — are not a warning ut a reflection of indecision.)

The fear of allied reaction to a more esolute policy seems to me similarly nwarranted. No doubt our allies ex-ressed their unhappiness from the eginning about any effort to make the oviets pay a heavy price. But I would argue that we were in a better position to challenge our allies over Poland, with respect to which I suspect European publics are more clear-sighted than their governments, than over the Middle East or Central America, which will be the next objects of contention. And, in the end, it is we who must lead in this alliance. We have a duty to make clear that restraint must be mutual. We must defend the policy of coexistence by defining not only its possibilities but also its limits. If we equate policy with a consensus of the fearful, we encourage the sense of impotence that breeds pacificism. Moderation is a virtue only in those who are thought to have an alternative.

As for Yalta and Helsinki, there is something self-destructive, almost masochistic, in the West's penchant to sell itself short. Yalta did consign Poland to the Soviet sphere of influence, but it also provided for free elections in Poland — quite the opposite of what is now happening. Helsinki accepted the principle that existing frontiers in Europe would not be changed by force — hardly relevant to the situation in Poland. But it also established international standards on human rights — standards being flouted daily.

The problem of economic sanctions is difficult, but not as maddeningly so as the West's response seemed to suggest. Admittedly trade sanctions have rarely worked, and were bound to be less than decisive in this instance as long as the United States was unprepared to stop grain shipments and Europe will not cancel its pipeline contracts. But in this crisis, the West had readily at hand an instrument even more significant than trade — Poland's colossal debt to Western banks, and its admitted need for $1.5 million of new capital from the West every quarter in 1982 just to stay afloat. And this — unlike trade embargoes, which almost daily pose questions about whether and how long they should be continued — requires only a single decision. Yet the fifth week of the crisis finds us still without a common policy on whether the allied governments will permit our private financial institutions to administer those essential transfusions of Western savings into the Polish economy.

Whatever can be said about the difficulty of economic sanctions does not apply to diplomatic intercourse, however. Here the decision whether to proceed is in executive control; no Congressional action is required. No private interests are at stake. Allied involvement in our bilateral dealings is at a minimum. How then can one explain the eagerness to continue all negotiations? How is one to reconcile the assertion that the Soviet Union is to blame for the suppression of Poland's freedoms with our continued participation in the Madrid Conference on the very Helsinki agreements that are violated so utterly in Poland? How is one to explain a meeting between our Secretary of State and the Soviet Foreign Minister while martial law and concentration camps continue in Poland? What is the compulsion to promote a Brezhnev-Reagan summit in these circumstances? What are our allies and other interested parties, for that matter — to make of the simultaneous pursuit of sanctions and high-level talks?

I am familiar with the counterarguments: that some negotiations are too important to be hostage to day-to-day fluctuations in international politics; that Madrid is a great forum for exposing Soviet culpability for events in Poland; that Haig will scold Gromyko; that Reagan will lay down the law to Brezhnev. The foreign policy bureaucracy never lacks ingenuity for devising rationales for its preference for talk over action and for its conviction that by the sincerity of our discourse we will moderate the behavior even of the Kremlin. But we scarcely need Madrid to castigate the Soviet Union; Washington and the United Nations would serve the purpose equally well and less embarrassingly. Foreign ministers' and summit meetings can be useful but not when their preparation goes blithely ahead — and is even accelerated — at the very moment that the first buds of freedom are being crushed in Central Europe. It cannot be national policy that we multiply high-level contacts during crises caused by the Soviet Union unless we want to give the Soviets an incentive to produce more crises.

I criticize with reluctance a foreign policy produced in part by so many friends and former comrades of difficult battles. They and their colleagues retain my full confidence. I applaud their dedication to a policy of coexistence. But they will not achieve this goal unless they devise penalties for intransigence together with incentives for moderation. Peace, to be meaningful or lasting, must ultimately reflect not only an accommodation but a sense of justice.

Henry A. Kissinger is now professor of international relations and associate of the Center for Strategic and International Studies at Georgetown University, in Washington. This is the first of two articles.

U.S. Officials Say Poland Is Paying Debt Unaided

(342) 1-28-82

By CLYDE H. FARNSWORTH

Special to The New York Times

WASHINGTON, Jan. 27 — Administration economic officials said today that the Soviet Union, contrary to speculation, has not been making international debt payments for Poland, but the Polish Government, from its own resources, has managed to pay $100 million in overdue interest owed to Western banks since the imposition of martial law six weeks ago.

Robert D. Hormats, Assistant Secretary of State for Economic and Business Affairs, and Marc E. Leland, Assistant Secretary of the Treasury for International Affairs, making the administration's first report to Congress on the financial implications of the Polish crisis, said that in view of the continued payments by Poland, there were hopes of preventing a default on the $16 billion in debt owed to 400 Western banks.

Poland expects to reach agreement with Western banks next week on rescheduling its loans. But the Polish Government is worried about the suspension of talks with its 16 creditor nations. Page D3.

They agreed in testimony before a Senate subcommittee on European affairs that the way to maintain maximum leverage on the Polish Government was to keep applying pressures for repayment. "The most important thing we can do about the debt is to try to collect it," Mr. Leland said.

In addition to the bank debt, Poland owes $10 billion to 16 Western governments, including $3.15 billion to the United States Government, according to a joint Treasury Department and State Department fact sheet submitted to the panel. Of the bank debt, $1.3 billion is owed to 60 American banks.

Deferral by Nations

Western governments, acting together, agreed last April to defer payments of Poland's debt to them. The banks, moving on a parallel track, agreed on Dec. 4 to postpone payment of $2.4 billion in principal due last year if the interest was paid quickly.

An estimated $700 million in interest fell due in the last nine months of 1981. When martial law was declared in mid-December, some $350 million had

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been paid, according to today's testimony. The Treasury-State Department fact sheet placed the amount of interest now due at $250 million.

The Administration officials said the Soviet Union had provided credits to Poland mainly to acquire Soviet goods.

Because the Soviet Union has been reported as a major seller of gold in Western bullion markets in recent weeks, speculation arose that they were using the money raised to help Poland avoid a default that would jeopardize the credit standing of all Eastern European countries.

Polish Exports Continue

In fact, according to Administration officials, this has not been the case. Although condition of the Polish economy was described as desperate, they noted that Poland was continuing to export, mainly coal, to Western European nations to earn foreign exchange and that these sales may have been the source of the funds used to repay the banks.

The Treasury-State Department fact sheet showed that Poland's debt to Western governments and banks has multiplied by nearly 20 times during the last nine years, from $1.6 billion in 1972, to $26 billion at the end of last year. Debt service — the payment of principal and interest — rose from 15 percent of exports in 1972 to 173 percent of exports in 1981.

The Treasury-State Department documents described the financial outlook as "extremely grave," noting that the gross national product of Poland declined by 15 percent last year.

"Shortages of spare parts and raw materials, because of the inability of the Government of Poland to obtain Western financing, presaged even further declines without significant economic reforms," the analysis said.

Soviet System 'Breakdown'

"What we are witnessing now in Poland," Mr. Hormats told the panel, "is a breakdown in the system that the Soviets have imposed on Eastern Europe."

He said the Soviet Union is seeking to turn its failure in Poland into a foreign policy victory by attempting to divide the Western alliance.

Mr. Hormats went on to say that "our objective is to maintain, and indeed strengthen, Allied unity in support of sustained pressures on both Poland and the Soviets to end the repression of the Polish people."

Both Administration officials ruled out an embargo on grain sales to the Soviet Union as a means of additional pressure.

They said that such restrictions would not be effective because the Russians would be able to obtain grain from other sources, as they had done during the partial curtailment of grain sales imposed by President Carter following the intervention in Afghanistan at the end of 1979. President Reagan lifted those restrictions soon after coming to office.

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U.S. Will Repay $71 Million Due On Poland Debt

(342) 7-1-82

By EDWARD COWAN
Special to The New York Times

WASHINGTON, Jan. 31 — The Administration has decided to repay $71 million that Poland owes to American banks. But the Government, which had guaranteed the loans, did not require the banks to declare Poland in default.

Unless rescinded, the decision puts in place a policy that would permit the Administration to repay, also without any formal declaration of default by the banks involved, $296.5 million of guaranteed debt that Poland is obligated to repay by the end of this year.

The money is part of $1.6 billion in loans to Poland that the Agriculture Department made or guaranteed to finance grain exports from this country.

The decision, which was reached last week, is an apparent concession to the worldwide financial disruption that would be triggered by a formal default of Polish debt to the West. The decision could rekindle a debate that flared in Washington, after the military takeover in Poland, about the best way for the United States to put pressure on Warsaw and Moscow.

In January alone, according to Government officials who asked not to be identified, Poland was scheduled — and

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failed — to pay $71.3 million of principal and interest under guaranteed loans. The schedule for the next few months, according to an Agriculture Department official, is for $52.9 million of such debt to fall due in February, $51.3 million in March and $31.7 million in April.

That Washington must satisfy the banks' claims under terms of the loan guarantees has never been in dispute, officials pointed out. The only question, they said, was whether an extraordinary procedure could be devised that would allow for repayment without having the banks formally declare the loans to be in default.

This was done when the Agriculture Department adopted an emergency regulation last week to permit such repayment. It did so without public notice, an official said, because notice was not required.

The banks with the loans were identified by a banker as Citibank, Chase Manhattan Bank, Morgan Guaranty Bank, Chemical Bank and Marine Midland Bank, all of New York City; Bank of America in San Francisco, the first National Bank of Chicago, the First Wisconsin National Bank and the Girard Bank of Philadelphia.

Timing of Action Unclear

The banks were notified of the repayment decision Friday, according to people familiar with the developments, although no funds have yet been transferred to their accounts. It was not immediately clear when the transfer would actually take place.

The decision to avoid a formal declaration of default was reached in interagency meetings of sub-Cabinet officials in the last two weeks under the leadership of the National Security Council. Initially the debate was intense, officials said, with the State Department and Treasury Department against default and Fred C. Iklé, the Under Secretary of Defense for policy, in favor of it.

A question debated in the interagency group was whether default would increase pressure on the Soviet Union to bail out Poland and possibly other Eastern European countries to avoid a breakdown of their trade with the West.

But by the week's end, one official said, "virtually everyone in the executive branch now agrees that this" — avoiding default — "is the better way." Mr. Iklé, regarded as one of the "hard-line" members of the Administration, refused to comment.

Keeping an Eye on Trade

Members of the State-Treasury group argued that a declaration of default would achieve no practical result and might create a situation in which Poland made payments to European banks but not to American creditors. Some officials also said default risked disrupting East-West trade. This is "something our European allies want to avoid," one official said.

Washington officials and New York bankers said the main reasons for the decision were the following:

¶A declaration of default would foreclose any further efforts to persuade Poland to pay interest or principal. "Once you declare a default as such, there's no reason for them to pay any money," a Treasury official said.

¶One or more of the nine American banks holding the guaranteed loans wanted to avoid formal default, while exercising their guarantees, because they would then be free to try to collect the unguaranteed portion of interest owed to them.

¶Formal default could trigger "cross-default" clauses in West German bank loans to Poland, an event that might force the Bonn Government to make good on some $2 billion of outstanding guarantees. However, a New York banker said he thought such wholesale triggering was unlikely.

¶Default would suspend Poland's application to join the International Monetary Fund. Some officials feel that bringing Poland into the I.M.F. is desirable because it would draw the country closer to the West and also require Poland to disclose more about its economy and finances.

How Procedure Works

Under the usual procedure for collecting on overdue guaranteed loans, a New York banker explained, the bank formally notifies the Commodity Credit Corporation that it wants the corporation to buy the loan. "That official notification is called notice of default," said the banker.

The emergency regulation lets the corporation offer to buy up the guarantee, officials said, at the same cost but without a notice of default.

Richard N. Perle, the Defense Department's assistant secretary for international security policy, said the United States itself, as lender and guarantor, retained the option of declaring Poland in default. "I don't think anyone can predict accurately the consequences," he said.

"It's just not in anyone's interest for a default to be declared," argued a New York banker. "It has no practical effect whatsoever. It will temporarily suspend Polish commerce worldwide for a certain period of time because ships and aircraft will be tied up and bank balances will be put on hold."

He was referring to the seizure of assets that creditors can make under default procedures in an attempt to recoup. Litigation usually results.

Washington Viewpoints

The banker continued, "If you were dealing with an entity that had large amounts of assets you could get your hands on, it might make sense to declare default." But Poland's identifiable assets are worth far less than its indebtedness, he said.

The so-called hard-line view in Washington is that default, by disrupting Polish trade and possibly the trade of Rumania and Hungary as well, would force the Soviet Union to pay Polish obligations in order to restore Warsaw's access to foreign suppliers.

The view of the State and Treasury Departments was that, without default, the banks and the United States Government could continue to put pressure on Warsaw to meet its obligations but that a declaration of default would amount to Washington's throwing up its hands and admitting it had no hope of being paid. Therefore, said one official, "keeping the pressure on this way is the real hard line."

The Washington Post

AN INDEPENDENT NEWSPAPER 2/1/82

Cut the Pipeline?

NO DOUBT the administration could put a crimp in the Soviet gas pipeline. If it could not altogether block it, it surely could delay and raise the cost of this $25 billion project to carry natural gas from Siberia to Western Europe. This is the largest East-West deal so far contemplated, and it is central to Soviet energy and hard-currency requirements in the late 1980s and in the 1990s. For the United States to do in the deal, as it is still considering trying to do, would unquestionably make the administration's point that the Soviet Union should be required to pay heavily for the repression in Poland.

Unfortunately, this is not the whole of it. It may not be the half of it. Some other hard realities must be cranked into any pipeline decision, and when they are, it is clear that for spoiling it the United States might pay even more heavily in its way than the Soviet Union would pay if the deal were spoiled.

"It boils down," one official told The Post's Dan Morgan, "to weighing the damage to the Soviet Union against damage to the alliance." Precisely so. For the Europeans consider the deal already made. Not unfairly, they regard any American inclination to reopen it unilaterally as harassment of a sort unworthy of their leading ally. For some years they have been warned by successive American administrations against becoming excessively and dangerously reliant on Soviet energy. Yet the United States has been unable to assure them of adequate alternative supplies, in the event that they could not purchase Soviet gas.

The gas would not be pumped for some years. Meanwhile, there are the jobs to be provided from making the pumps and the pipes and the rest of it. The recession is hurting in Europe, and the economic benefits of the pipeline would be immediate. Moreover, even if the United States did decide to move against European companies planning to produce pipeline equipment under license from U.S. firms—and this is the favored approach—other ways would doubtless be found to produce that equipment. The technology is simply not all that esoteric. Can you imagine, by the way, the reaction that would follow application of one of the sanctions that the administration is said to be weighing—the arrest of an officer of one of the offending European companies who had flown into Dulles or JFK?

We leave to last the matter that is, for excellent reason, first on almost every European's lips. Is it not yet clear to this administration that, by continuing to sell massive amounts of grain to the Soviet Union, the United States loses any serious claim to ask for painful sacrifices from its European allies? In contrast to a pipeline cutoff, a grain cutoff would have not just a political and symbolic effect but also an immediate and real impact on the Soviet Union. It would bring home in a fashion that no other sanction can the West's disapproval of what the Soviets have done in Poland. Yet Mr. Reagan holds back, citing a campaign promise.

At this point in the discussion, one can hear from not far offstage a host of mutterings about the sapping of the will of the West, the inability of the democracies to coordinate policy in their own defense, the readiness of capitalists to sell their adversaries the rope for their own hanging, and so on. These are not insubstantial complaints. They go to structural as well as political flaws in the alliance. They require the continuing attention of serious people.

Unless the United States really means to go it alone, however, it cannot respond to these difficulties in a manner that makes it all the harder for the allies to be brought along on this and other matters. This would be the likely effect of an American decision, taken over the Europeans' protests, to cut a pipeline intended to provide their gas. Certainly the United States cannot so respond without first deciding, very carefully, that it is not worth it even to try to bring the allies along. If the Reagan administration means what it says about the continued validity of the Atlantic alliance—and we think it does—it must act on the basis of that fundamental fact, not simply on the basis of its frustration.

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Naked at the Microphone

(342) 2-2-82

The Reagan Administration has come perilously close to confessing that all its fulminating about Poland is bluster. While demanding in television propaganda that the Kremlin "Let Poland Be Poland," it has devoted its real energies to letting Warsaw and Moscow avoid the penalties of Polish bankruptcy. Furtively, the Administration has paid off a Polish debt of $70 million to American banks and thus set the stage for paying $400 million more in 1982. The threats of credit squeeze, by which the President wanted to stiffen the bargaining power of Poland's Solidarity union and Catholic Church, are thus evaporating into hot air.

The debts in question are guaranteed by the American Government, so this is no raid on the Treasury. The offense is procedural — contorting the rules to avoid a formal Polish default. But it remains an offense; such panicky concern for Western banking can only confirm the Communists' contempt for capitalist diplomacy.

Poland is bankrupt. It owes the West about $27 billion. Governments either lent or guaranteed more than half of that, so private banks are at risk for $10 or $12 billion. West Germans are the most exposed; American banks have bad debts of $1.2 billion. But as long as Poland paid interest on these sums, no one spoke the dirty word "default"; its loans were dutifully renewed to avoid the shock of writing them off.

This "rolling over" came to a halt with the declaration of martial law in December. Mr. Reagan imposed modest sanctions against Warsaw and Moscow but threatened more if the suppression continued. Given his distaste for a Soviet grain embargo, that meant only one thing: no new credits and a formal default that might damage all Communist credit.

The European allies were reluctant to follow that path, fearing not only the jolt to banks but the loss of Communist trade. Every creditor, however, held the power to force default and set off a scramble to seize Polish assets and rescue the West's banks.

There matters stood when American banks failed to collect $70 million in January and asked the Agriculture Department, as guarantor, to make them whole. In the dead of night, Agriculture changed the rules that required a prior notice of default and paid Poland's debt. The State and Treasury Departments insisted on this subterfuge to "protect" the credit markets. And they left their President naked at his microphone.

It is obviously foolish to ignite a banking crisis that injures the West more than the East. But as Felix Rohatyn and others observe, chaos is not the only alternative to inaction.

If economic pressure is to be the West's main diplomatic weapon, the Polish debt should by now have been nationalized by all Western governments so that they can truly manage it. That requires buying out the banks' uncovered holdings at, say, 50 cents on the dollar, and then, as the price of more credit and orderly trade, demanding that the Soviet bloc respond with reliable payments and humane rule in Poland.

In the back of every banker's mind has been the thought that the Kremlin was good for the entire $70 billion lent to Communist countries in recent years. If America now insists that the most brutal Soviet methods will not be condoned in the service of this debt, then it has to employ the only significant leverage at hand: make the Russians pay for the luxury of their tyranny — or quit the hand-wringing.

It is almost too late to restore the President's authority, but not quite.

U.S. Tells Its Banks Some Polish Debts Will Be Paid

FEB 2 1982

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By Dan Morgan
Washington Post Staff Writer

Under a procedure aimed at preventing a chain reaction of international financial defaults, the Reagan administration has informed U.S. banks that it will pay back some of their loans to Poland until the hard pressed East European country can resume redeeming its debts.

A policy adopted last week—after heated debate in an interagency working group—authorizes the Agriculture Department's Commodity Credit Corporation to pay the banks the delinquent loan principal and some of the interest as it comes due over the next few months.

The loans were guaranteed by the CCC during the last three years so that Poland could purchase wheat, feed grains, soybeans and other farm commodities here with the aid of private credit.

There was never any doubt that the U.S. government had a legal obligation to cover these loans if Poland failed to pay. However, administration officials favoring a tougher stance in the Polish crisis have argued that the banks should formally announce that Poland was in default and attempt to seize assets, such as ships, before the government honored its guarantee.

Considerable sums of money are at stake in the guaranteed loan program. In January, Poland failed to pay the U.S. banks $71 million in principal and interest. For fiscal 1982, the total exposure on guaranteed loans comes to $308 million, and in the next two fiscal years, the total owed to the banks and guaranteed by the CCC comes to $613 million.

Government sources said yesterday bankers were concerned that their claims to the CCC against Poland's unpaid loans could be taken by other banks as a formal announcement that Poland was in default on its international obligations. This, in turn, could trigger a chain reaction by some 500 banks to which Poland owes money here and abroad.

To reduce the default risks, the sources said, the government gave the banks two options, both involving the CCC's picking up the Polish obligations as they came through. One option is for the CCC to cover the loan principal and 6 percent of the interest. The other option calls for the CCC to pay only the principal owed and to receive interest out of a common "pot" of Polish payments that would go to repay the banks and the U.S. government.

The New York Times, in a news report and in a column by William Safire, reported that the procedure for handling the unpaid loans involved drafting an "emergency regulation."

Safire blamed a "craven State Department" for accepting a recommendation by Deputy Secretary of Agriculture Richard E. Lyng that the bank guarantees be honored without forcing Poland into default. The Safire column, under the headline "Payoff for Repression," referred to "hardliners" who feel the administration has failed to back up its tough public statements against military rule in Poland with deeds.

Those in the administration who oppose throwing Poland into default argue that such a move would be counterproductive. They say it would provide the Soviet Union and Poland with an excuse to ignore its financial obligations to the West, and would sacrifice a major piece of leverage.

One New York City banker yesterday objected to suggestions that the government was rescuing the banks from the consequences of a default.

"The governments [in the West] have a heavy responsibility for this whole mess," he said. He said that U.S. government loans and loan guarantees to Poland have risen much faster in the last 18 months than private banking loans. "If the government is not willing to declare a default on its loans and to go out after the Poles, why should they send the banks out to do it?"

U.S. officials acknowledged that Poland's failure to pay its debts had created an unprecedented problem at the CCC. Several years ago Sudan defaulted on a loan repayment to CCC, but the amount was only $9 million, sources said.

2-3-82

REVIEW & OUTLOOK

Congress's Chance on Poland

It looks as if the battle for freedom in Poland is going to have to be taken to the floor of the U.S. Congress. With Ronald Reagan's administration slipping into tacit collaboration with martial law by making it easier for the Soviet bloc to finance repression, any serious action against the Polish regime will have to be taken by another branch of government.

It turns out that the administration, far from calling in the Polish debt to hamper the flow of credit to the Soviet Union and its satellites, is bending U.S. law to keep Poland out of bankruptcy. The Commodity Credit Corporation provides government guarantees to banks financing grain shipments abroad, offering to repay the banks if foreign governments cannot. For ordinary, non-Communist governments, no payment is made until the bank declares the loan in default. But in the case of Poland, this was deemed too embarrassing.

So the State Department lobbied to change the CCC rules, and the administration decided to pay off $71 million to the banks without their declaring a formal default. This is a down payment on about $400 million in guarantees on Polish loans due this year. No sooner is the decision taken than Secretary Haig rushes off to Chicago to spend Solidarity Day posturing before Polish voters as a tough guy on Poland.

One point that begs attention is how this decision was reached. At what level of the government was it decided? Did the President understand the full implications of the change in the rules? Did the National Security Adviser? Where was the Treasury? (The undersecretary for monetary affairs says he's under instructions not to discuss the issue.) Was the Defense Department even consulted? Was this the foreign policy equivalent of the decision to change the tax status of segregated private schools? Everything we learn leads us to suspect that the answers to these questions would be profoundly embarrassing, that this is another example of sloppy management at the White House.

A second point concerns the banks. They have refrained from declaring a default in Poland because the write-downs would hurt their earnings. It would also hurt their chances of doing new business with the Communist dictators of Poland and the rest of the Soviet bloc. But the real question is how did U.S. and other Western banks make all these bad loans, and how can we stop them from doing it again?

The banks have made the loans because Western governments encouraged them to do so, implicitly suggesting that loans to Communists had a favored position, deserved lower rates and would more or less be backed by Western governments. The CCC deal can only encourage this notion. The Soviets rushed to get the gas pipeline deal and other credits wrapped up before the Polish crackdown, and with the new incentives just demonstrated by the Reagan administration, the flow of credit will resume again as soon as the bad press dies down.

The U.S. government ought to at least stay neutral toward Communist loans. The Polish loans clearly are sick, and probably terminally so. The banks ought to be establishing large reserves against them—we have previously suggested 50%—as a matter of pure commercial prudence. The government ought to be encouraging them to do this, not helping them avoid it, to limit the commercial damage from any forceful foreign policy initiative. Instead, the Reagan administration sponsors a TV show.

Fortunately Congress will have an opportunity to show greater forcefulness, for it controls the power of the purse and bail-out money has to come from somewhere. Specifically, it would come from House Joint Resolution 389, a budget-busting supplemental appropriation of $5 billion for the CCC. This measure has been marked up—with unseemly haste—in the agriculture appropriations subcommittee by the Mississippi Democrat, Jamie Whitten. The main purpose is to provide pork for American farmers, who are calling on their CCC entitlements because of low farm prices. But a lot of the money—between $500 million and $1.5 billion, so far as we can learn—could be used to bail out repression in Poland.

It would not be the worst thing in the world if this whole supplemental were grounded, farm price supports being one of our least favorite subsidies to the land-owning poor. But if Congress is going to bail out the American farmer, it can at least write in an amendment prohibiting the use of these tax funds to bail out Polish dictators, at least until a default is declared and the economic lessons of Poland digested.

Haig Defends Loan Policy On Poland

By RICHARD LAWRENCE
Journal of Commerce Staff

WASHINGTON — The Reagan administration is not "foreclosing" the possibility of declaring Poland in default of its U.S. borrowings, according to Secretary of State Alexander Haig.

In Senate testimony, Mr. Haig strongly justified, however, the administration's decision last week to repay $71 million in Polish debt to U.S. private banks. The loans had had U.S. government guarantees.

By keeping Poland from default, he argued Tuesday, "pressure" will be kept on Poland and the Soviet Union to meet their international financial obligations.

Letting Poland slip into default, he said, could "cost" Western nations more than the Soviet bloc. Poland, he implied, might then be tempted not to repay the roughly $26.5 billion it owes to the West.

The Soviets, are suffering "serious" economic problems, selling their gold at "an unprecedented rate," to earn foreign exchange, he noted. The present Polish government is expected to have to rely increasingly on Soviet aid.

By calling Poland in default, Mr. Haig told the Senate Foreign Relations Committee, "we would have done the work of the Soviet Union, not the American people."

"Amen, brother," said Sen. Jesse Helms, R-N.C., a senior committee member.

Mr. Haig said the decision to repay the $71 million was made by President Reagan "personally," after a "unanimous" recommendation by his advisers for the action. The repayment drew no outright criticism from Foreign Relations Committee members at Tuesday's hearing.

Both committee chairman Charles Percy, R-Ill., and Sen. Charles Grassley, R-Iowa, seemed concerned, however, that the U.S. government might repay as much as $396 million in Polish debt due this year to U.S. banks. The debt represents U.S. government guaranteed financing of Polish grains imports. Some $53 million of it comes due this month.

Altogether, the U.S. government has extended $1.6 billion in grains financing to Poland, including direct loans from the Credit Commodity Corp. Sen. Grassley, who termed the financing an unprecedented "stretch" of CCC programs, drew from Mr. Haig the acknowledgement that the loans were "distortions" of the CCC "process."

Mr. Haig appeared to suggest that in the future the administration would take less of "an ad hoc approach" in addressing Polish financing needs.

Reprieve on Polish Debt

Despite Tough Talk, U.S. Found Avoidance Of Default Declaration Was Practical Need

(342)

By LESLIE H. GELB
Special to The New York Times

2-3-82

WASHINGTON, Feb. 2 — The Reagan Administration seems at times to be at war with its own self-image of toughness in foreign affairs. One result is that officials sometimes have to defend decisions that do not measure up to their strong statements.

News Analysis

The most recent case is the Administration's decision to pay American banks $71 million they are owed by Poland and to sidestep declaring Poland in default on those debts.

As a symbol of toughness, there is nothing that many senior Administration officials would like to have done more than to have declared Poland in default. Thus, in effect, by declaring that Poland was unable to pay its debt, they would be taking the final step toward breaking economic relations.

But from a practical standpoint, there were too many risks and uncertainties for the Western alliance and economic system.

Up to this point, the Administration has decided that a formal declaration of default would be self-defeating. The rationale was that the Western banking system might be hurt as much as, or even more than, Poland by such action. Poland might be driven even further into Soviet hands. Western Europe would be up in arms.

Decision Described as Realistic

Better for now, it was felt, for the American taxpayer to pick up the tab on the Polish loans than to engage in gestures. Better for now to risk the wrath of some conservatives in America.

Now that the decision has been disclosed publicly, Administration officials have closed ranks, and they all describe it as tough and realistic. But they are also saying that the story is far from over.

Secretary of State Alexander M. Haig Jr. told a Senate committee today that President Reagan's decision was the "hard position, the more rigid position."

"The facts are that the action he took will require the Soviet Union to make the money good," Mr. Haig said. "Had we called default, they would have been relieved of that burden."

Before the issue came to the point of decision, default was seen as a touchstone of toughness and key Administration officials, above all, did not want to appear weak to Moscow and to conservatives at home. As one high Administration official put it, "We keep giving signals about being willing to go to the brink and backing away."

But last week, when they were faced with the problem, representatives of every department involved except the Pentagon were most impressed with practicalities and not symbolic gestures. And they quickly decided that the practical steps were the tough ones as well.

Various Departments Represented

The principal participants in the decision that was presented to President Reagan for his approval were: Beryl Sprinkel, Under Secretary of the Treasury; Lionel H. Olmer, Under Secretary of Commerce for International Trade; Robert D. Hormats, Assistant Secretary of State for Economic and Business Affairs; Fred C. Ikle, Under Secretary of Defense for Policy; Richard E. Lyng, Deputy Secretary of Agriculture, and Norman Bailey of the National Security Council staff.

In the first place, they all agreed that Poland could not pay its debts. If default were declared, Poland would not have to pay, whereas if the debts were assumed by the United States, specifically by the Agriculture Department, there might be some chance of getting some money from Poland in the future, although no one was very hopeful about this.

The participants all agreed quickly that the key question was how a default declaration would affect the international monetary system. They consulted Western European leaders and bankers in the United States and Europe. All strongly urged against the default declaration, fearing that it would set off other default declarations against Poland, particularly in West Germany, which has a much larger stake than American banks. If this happened, no one was sure where it might end.

Situation Full of Imponderables

The participants were not necessarily convinced that all this would transpire, but they recognized that the situation was tricky and full of imponderables, and they were under a great deal of pressure from the banking community and the allies to refrain from declaring a default.

The only one who argued in favor of declaring Poland in default was Mr. Ikle. He stressed the importance of such a gesture and asserted that the move would have to be taken sometime. Without support, he backed off.

The officials also recognized that if they were to recommend sidestepping the default procedure, they would have to act quickly before counterpressures for a default might build in the United States.

Rallies were being held around the country that week to show support for Solidarity, the Polish labor movement, and many prominent speakers such as Lane Kirkland, president of the A.F.L.-C.I.O., were advocating a declaration of default. Thus, they decided that the Agriculture Department would adopt an emergency regulation that would allow for paying the banks without declaring a default. As permitted, this was done without public notification.

Credit Squeeze Already in Effect

To the extent that they had any hold over Poland, they agreed that it stemmed from the general credit squeeze that they had already set in motion. The United States and its North Atlantic Treaty Organization allies have already called off negotiations with Poland on rescheduling its 1982 debt. This, they agreed, was already drying up the flow of credit and in a way that was allowing the banking system to adjust slowly. And to the extent that the United States had any real economic leverage over Poland, they thought that this was the way to manage it.

Also, the officials taking part in the deliberations agreed that the crisis was a continuing one. More would have to be done later, it was argued, and the President needed to hold something, such as the default declaration, in reserve for future use.

This position was presented to President Reagan by William P. Clark, the national security adviser. Mr. Reagan gave his blessings, although his role was not described as extensive.

"All options remain open," Secretary Haig told the Senate Foreign Relations Committee today.

But to officials in almost all the departments involved in this exercise, the options are closing. Whether they like it or not, and whether or not they think it is practical, they convey the sense that a harder stance is in the offing and that President Reagan has publicly committed the United States to take "further steps" if the situation in Poland does not improve. No one seems to see much prospect of improvement.

Role of the Western Banks in Poland's Debt Crisis

By PAUL LEWIS
Special to The New York Times

PARIS, Feb. 1 — The economic difficulties in Poland and other countries of Eastern Europe have presented Western bankers with a dilemma at least partly of their own making.

News Analysis

Private Western banks were liberal lenders to the Communist bloc during the 1970's. They regarded Eastern Europe as a stable and profitable market, reasoning that the Soviet Union would be ready to come to the aid of its satellites rather than let them lose their creditworthy standing.

Now that Poland is unable even to pay the interest on its vast debt, critics of the Western banks accuse them of having lent more money than was prudent, thus contributing to the Polish financial crisis. The banks are further blamed for aggravating the crisis because they are unwilling to extend additional credit to Poland now.

The banks could declare Poland in default on the debt it has not repaid, but they are unwilling to do so. If they did, they would be acknowledging that they had misjudged the credit risks involved.

"Many loans were made on faith alone," said James Worton, a banking analyst for Merrill Lynch, Pierce, Fenner & Smith.

Behind a Wall of Silence

Under fire from their critics, Western bankers have retreated behind a wall of silence. A typical reaction was that of Wilfrith Guth, head of West Germany's Deutsche Bank, who reassured a Duesseldorf audience that the world financial system would survive the loss of loans made to Poland but refused to answer any questions about his cheerful conclusion.

The Polish crisis has shattered any illusions the bankers may have had. They are now confronted by the specter of losing loans worth $18 billion. Last week Western bankers agreed to give Rumania more time to repay what it owes. Bulgaria and East Germany may need similar help soon.

"Western banks thought centrally planned economies could always be kept solvent, but they are too inflexible," said Paul Marer, an Indiana University professor.

The Western banks remain reluctant to declare Poland or any of its neighbors in default. Issuing such a declaration would be a public admission that the banks had overextended themselves. And the banks are far from eager to advance additional money to help the Eastern bloc regain economic solvency.

"They are sitting on fences, trying to protect their assets without increasing their risks," said Richard Portes, a London University professor who published a study of Poland's debts last year.

Urging a Tougher Stance

In recent weeks several experts on international affairs have suggested that the West could turn Poland's huge debts to its own advantage by adopting a tougher stance than even President Reagan has envisaged. Instead of imposing trade sanctions, they argue, the West should declare Poland in default, authorizing the banks to seize whatever of its assets they could and forcing the Soviet Union to assume responsibility for the Polish economy. The resulting squeeze on Soviet resources, they conclude, could hamper the Russians' military buildup.

Felix G. Rohatyn, the American investment specialist who helped straighten out New York City's financial affairs, recently declared: "We should put the economic burden of the satellite states squarely back on the Soviet Union and point up the bankruptcy of the Communist system by declaring bankrupt one of its units. When the economic burden grows sufficiently heavy, the Soviet Union may become more accommodating and, together with the United States, may find it in its self-interest to reduce drastically defense budgets neither can really afford."

Henry A. Kissinger, former Secretary of State, said, "Poland's colossal debt to Western banks is the best leverage we have."

Assets or Liabilities?

Yet Poland's major creditors have consistently refused to place the country in default, using all their influence to keep the smaller banks in line, according to banking sources. If Poland were formally declared in default, the banks' loans to Poland would cease to be listed on their books as assets. Instead, the loans would be listed as liabilities, to be charged off against reserves.

A senior French banker, who asked not to be identified, commented: "You've got to be cynical. Everyone knows Poland is in default. But if we say so, we admit that we're bad bankers who made loans we never should have made."

Western bankers are also accused of inconsistency as they try to salvage something from Eastern Europe. Last November, after Poland said it would be unable to repay its existing loans on schedule, the private banks agreed to new, easier repayment terms if Poland brought its interest payments up to date by year's end.

Simultaneously, however, the private banks withdrew more than $1 billion in short-term deposits from Poland's central bank, making it impossible for the country to make the interest payments and perhaps speeding the Polish economic collapse, which was followed by a military takeover.

"Withdrawal of the balances makes it very difficult to halt the industrial decline because we have no foreign currency for imports," said Poland's Finance Minister, Marian Krzak, in an interview last October.

In a recent study, Yves Laulan, chief economist at Société Générale, the French state-owned bank, estimated that Poland would need more than $15 billion in extra assistance this year and injections of additional billions over several years to save its economy and repay its debts. Mr. Rohatyn has suggested that $20 billion to $30 billion of additional capital will be needed. But there is no sign that the Western banks will lend any more money to Poland.

On the contrary, some bankers have conceded privately that they welcomed the military crackdown as the best way of getting the Poles back to work so their nation's debts could be repaid. Overcoming a 30 to 40 percent drop in industrial production, however, would seem to be no simple task.

Worry About a Depression

Meanwhile, governments of the Western countries where private banks started the lending spree worry that a Polish default would set off a financial panic and worsen the international recession. Last month West Germany's Chancellor, Helmut Schmidt, asserted that a depression, not Soviet adventurism, was the greatest political danger now facing the West.

Critics of the banks accuse them of dividing the Atlantic alliance. Unlike Washington, the governments of Western Europe are generally reluctant to impose severe trade sanctions against the Soviet Union and Poland because these would make debt repayment even more difficult and might aggravate unemployment in the West.

"The banks have a lot to answer for," said one of the critics, Professor Portes of London University.

WEINBERGER SEEKS TO DECLARE POLES IN A DEBT DEFAULT

ADMINISTRATION IS DIVIDED

Aides Says Secretary Believes a Hard Line on Loans Can Block Soviet Pipeline

By HEDRICK SMITH
Special to The New York Times

WASHINGTON, Feb. 3 — Secretary of Defense Caspar W. Weinberger reportedly intends to keep pressing to have Poland declared in default of its debts to the West and to have Western European nations halt their natural gas pipeline deal with Moscow.

On the recommendation of the State, Treasury and Agriculture Departments, President Reagan recently agreed to have the Administration pay American banks the $71 million owed them by Poland to forestall a declaration of default and the ensuing disruption of East-West economic relations.

But, in the continuing debate on the question within the Administration, high Pentagon officials oppose this action. They insist that the issue of Polish default has not been finally settled. Mr. Weinberger is known to favor the tougher stance of allowing default and the disruption of Western credit relations with the East to impose an economic penalty on Moscow and Warsaw for the repression in Poland.

Salvadoran Intervention Opposed

On the issue of El Salvador, however, Mr. Weinberger opposes American combat involvement and and is understood to be wary of military operations in the Caribbean, such as a blockade of Cuba or Nicaragua, that would require Congressional approval.

Tuesday, in Congressional testimony, Secretary of State Alexander M. Haig Jr. seemed to reopen the threat of American intervention in Central America by asserting that the United States would do "whatever is necessary" to prevent the overthrow the Salvadoran Government by leftist guerillas. Today, Larry Speakes, a White House spokesman, left Mr. Haig's comments standing but emphasized that there were no plans "at the moment" for American troops to go into combat in El Salvador or elsewhere.

Mr. Speakes said the Secretary "was discussing contingencies," and added, "The President has said he has no plans to send troops anywhere and he has no plans."

A high Pentagon official, acknowledging domestic pollical opposition to American military involvement, added that "one of the lessons of Vietnam is that we can't engage in a war that is not supported by American public opinion."

In coments on another, more distant trouble spot, a senior Administration official revealed rising concern over reports that the Soviet Union was providing aid to the Communist Tudeh Party

Continued on Page A5, Column 1

in Iran and was "very likely" sending arms and military supplies across the Soviet-Iranian border to other groups fighting the regime of Ayatollah Khomeini.

On the issue of possible Polish default, Mr. Weinberger was reported to have been taken by surprise by the Administration's decision to pay off the American banks, primarily because he had been preoccupied with preparation of the new Pentagon budget. But since the Defense Secretary did not get a chance to press his own views on the issue with President Reagan, the Pentagon does not regard the matter as settled.

Mr. Weinberger is said to feel that the recent decision to bail out the banks was an "interim" action. He is said to believe that the question is still "a live issue" among Administration policy makers and certain to be reconsidered as future installments of Polish debts come due.

"This is a continuing debate," a high Pentagon official said. "The default issue is with us continuously. There are quarterly payments due so it will come up again. It's a live issue."

The default question is linked in Mr. Weinberger's opinion to the pipeline deal, which has for months been a major target of Pentagon officials and American diplomats.

The Defense Department's view, reportedly backed by William J. Casey, Director of Central Intelligence, is that the pipeline would not only make Western Europe dependent on Moscow for vital energy supplies but would also earn the Soviet Union about $10 billion a year in hard currency that could be spent on Western technology with military applications.

Mr. Weinberger is understood to believe that a Polish default would not only impose further economic burdens on the Soviet Union but would delay the pipeline. The Administration concedes, however, that West European banks and governments are shying away from this approach.

Mr. Weinberger's arguments with the Western Europeans is that the West should not help the Soviet Union develop its oil and natural gas resources, especially when Western intelligence estimates project Soviet shortages in the years ahead.

In the Reagan Adminstration's internal debates over Poland, Mr. Weinberger and some of his Pentagon aides have taken the most pessimistic view of developments. Recently, for example, Mr. Weinberger commented that he felt "the Polish Government is run by a Russian general in a Polish uniform."

Although he is known to favor most policies that would make it harder for the Soviet Union to obtain new arms and support the military regime in Poland, Mr. Weinberger has not pushed for covert operations in support of Polish resistance to martial law.

The Administration's announcement Monday that the Government would pay American banks rather than allow Poland to go into formal default has come under fire from conservative groups.

"Default would require the Soviet Union, rather than the American taxpayer, to bail out the bankrupt Polish Government," Howard Phillips, leader of the Conservative Caucus, said today.

Mr. Phillips said at a news conference that his organization had launched a $100,000 letter-writing campaign to urge banks to force Poland into default by seeking immediate repayment of outstanding Polish loans.

Journal of Commerce
AND COMMERCIAL
NEW YORK, THURSDAY, FEBRUARY 4, 1982

Soviet Union Assails US Position On Poland's Debts With West

By ALBERT AXEBANK
Journal of Commerce Special

MOSCOW — The Soviet Union criticized Washington's attitude toward Poland's Western debts. It alleged that the U.S. government's decision to pay American banks $71 million was not a matter of "kindness" but rather one of "egoistic self-interest."

The Soviets contended that the Reagan administration risked, if it declared Poland bankrupt, the loss to the Western banks of approximately $28 billion.

Poland reportedly owes American banks a total of $1.5 billion in earlier granted loans. Recently, the U.S. Treasury Department is said to have considered an action to declare Poland a "bankrupt country."

Western bankers in Moscow say the risks are growing in the international lending market. They say banks in the West are studying how to provide for contingencies to help ease the possibility of losses as, for example, from the Polish financial plight.

Recently, the U.S. Treasury Department is said to have considered an action to declare Poland a 'bankrupt country.'

Some Western sources have suggested that to declare Poland in default on its financial commitments would not really serve the interests of Western banks. The Soviets, meanwhile, have contended that such a move would bring only "transient political satisfaction."

But, the Soviets added Wednesday, such a step also will "deal a potentially destructive blow to the positions of Western banks.

"It should be recalled that Western Europe's business circles have long been looking at the existing situation from a notably more realistic viewpoint than Washington was until recently," the official Tass news agency said.

Tass praised a number of Western comments on the Polish financial situation.

The agency said many Western observations on the Polish financial predicament "reflect the opinion of sober-minded circles which are aware of the fact that the West should show interest in the existence of a stable and economically strong Poland, and not pursue a policy of incitement and destabilization of the situation in Poland."

The agency also stated that many heads of Western banks apparently realize that "it is important for them to refrain from showing political inclinations."

However, added Tass, "far from everybody in the U.S. administration follows this reasonable advice. And they may eventually end up by estimating their own financial losses."

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Debate Continues in Cabinet on Whether to Force Poland to Default

By Michael Getler
Washington Post Staff Writer

Despite the administration's decision last week to pay American banks $71 million in interest they are owed by a virtually bankrupt Poland, a senior administration official says the debate is continuing within the Reagan Cabinet on whether eventually to force the martial-law government of Poland into default on its debts.

Similarly, the official—who made clear his preference for calling Poland into default—also said that he was not prepared to give up trying to get West European banks and governments to back away from financing and helping build a $25 billion natural gas pipeline from the Soviet Union to Europe. This is the largest East-West project ever attempted.

The official, who met with a group of reporters over dinner Tuesday night and spoke with the understanding that he not be identified, is a major participant in defense and foreign policy issues and is close to the president. His views reflect some of the hardest-line advice being received by Ronald Reagan as his administration grapples with a fundamental question: how should the United States handle its economic relations with the Soviet Union, which many administration officials view as a grave and growing military threat?

Although the administration thus far has pursued a relatively moderate course, this influential official made clear his view that detente or a so-called "ostpolitik" policy of improved relations with the communist East "is not a policy that we should follow. There is substantial danger in it." He believes its practice by the West in the past had no effect in slowing down Moscow's military buildup.

The official talked of a total trade embargo against Moscow as an option under study as the administration continues to ponder the Polish crisis. He suggested support for this, in part because it would cut down on militarily useful technology being shipped to the Soviets.

Although Reagan has also alluded to a possible total trade embargo, other officials said this would probably only be imposed in the face of some new and especially grave Soviet action.

As this official sees it, there is a clear link between the Polish debt and the Soviet pipeline.

Declaring Poland in default on payment of its massive debts to the West would "bring the message home" to Moscow about American dismay over the crackdown in Poland and would have a "very disruptive" effect on the Soviet Union, the official said. It would "deter" construction of the pipeline because the line of western bank credit to the communist East would unravel, he indicated.

The official said what worried him most about the pipeline deal was the $10 billion a year in western currency flowing to the Soviets for their gas and furthering their military buildup.

The official described last week's decision to pay off the American creditors "just an interim thing" in the minds of many officials. Because of Poland's massive debts, the issue will be protracted and there will be opportunities to change the decision.

In defending the decision to avoid default at this time, Secretary of State Alexander M. Haig Jr. has said that it maintains the burden on both Warsaw and Moscow to pay off their debts eventually. With the exception of the Pentagon, there was unanimous support within the administration group that decided to avoid default.

Although the official claimed the Cabinet is unified in trying to stop the pipeline, it is known that there are significant divisions in the government between those taking the hardest line and those who believe the damage to American allies in Europe would outweigh the punishment to Moscow.

REVIEW & OUTLOOK

The Burns Cable

One of the key issues in the debate over whether the Reagan administration ought to declare Poland formally in default on its debts to the U.S. government is whether such an action would cause a crisis in the Western banking system. Nearly everyone agrees that U.S. banks could easily ride out such a shock, as about 60 American banks hold a scant $1.2 billion, or so, in Polish paper. But the State Department has been arguing the U.S. should continue to subsidize credit to Poland because to get tough and declare a default would cause a crisis in West Germany, whose banks hold the biggest exposure.

Now, however, the State Department has received a confidential cable from the U.S. envoy in Bonn, Arthur Burns, that makes us wonder. Mr. Burns, lately of the Fed and now on the spot where any financial crisis would start, sent his cable Jan. 29. In essence he makes three points: First, most of the effects of a Polish default will happen with or without a default. Second, the financial ramifications of default would be easier for the Western banking system to swallow if it were spread over several years, avoiding official default now but presumably requiring banks to establish reserves to cover their Polish losses. And third, that if default did happen now and make the banks swallow their losses in a gulp, the problems would still be manageable.

The Burns cable doesn't suggest there won't be serious consequences. But he says the more serious secondary effects of the Polish financial crisis are probably going to be felt even if a formal default isn't declared. He reports the Polish experience will make international banks a lot more cautious in lending to the Soviet bloc, which in turn will cause the Soviet bloc to cut back on imports from the West. Without a lot of new Western credit flowing in, other Soviet bloc countries could run into financial trouble. This would mean the German government could be forced to help its banks save some subsidiaries from going bust.

Too, with or without a declaration of default, the Polish experience will make international banks increasingly reluctant to make new loans to Third World countries with weak balance of payments positions, Mr. Burns says. And this, too, could have repercussions on Western banks of the sort that Poland might have more directly. So Mr. Burns says he's been telling German businessmen and newspapermen that Western bankers have awakened to the fact that their lending to socialist countries wasn't too bright and that they have to proceed more cautiously, while German businessmen will have to turn to Western markets.

What strikes us about the Burns cable—in the context of all the shrill doomsaying we've been hearing from the State Department—is the absence of any suggestion that getting tough would bring down the Western financial system. From the narrow financial standpoint, Mr. Burns would of course prefer to avoid sudden default and spread the losses over time. But there is far from anything that sounds like a prediction of catastrophe if this is not done.

Even from the financial perspective, Mr. Burns's judgment call depends crucially on his estimate that the Western banks have already learned their lesson. We wish we were sure. For one thing, banking regulators have not yet instructed the banks to start reserving against Polish loans. New credits are rolling forward in the pipeline deal. The Communists may well be right in their calculation that six months from now everyone will be back at the same bazaar stalls.

More fundamentally, though, the reasons for default transcend mere commercial considerations. The Soviet system does not disturb us because it cannot pay its bills. The Soviet system disturbs us because it has devoted its economy primarily to a military buildup that threatens our national security. Because of inherent inefficiency and the demands of its military sector, that economy is now staggering. Its dependence on the West is epitomized in the Polish debt, and the effects of default in inhibiting further credits and trade would be a punishing blow at its most vulnerable point.

More broadly, default would make clear the message that we will no longer finance a military machine that threatens our own well-being. It would prove that we are not without means to exert in this struggle, nor without the will to do so. If we let the opportunity slip by, we will only confirm the commissars' estimate that they have little to fear from the West, that there is no reason to slow their military buildup or moderate their aggressive foreign policy. And the confirmation would come with double force from a President elected with a mandate to restore some spine to our position in the world.

Washington Talk of Polish Loan Default Has Made Western Lenders Very Nervous

By Julie Salamon
Staff Reporter of The Wall Street Journal

NEW YORK—Rumblings from Washington that the Reagan administration should push Poland into default for failing to pay its debt are making Western bankers extremely anxious.

The bankers have tiptoed around discussions of default since martial law was declared in Poland in December, because the last thing they want to do is risk losing out on the entire $10 billion that Poland owes them.

"We've tried to do all we can to avoid pushing the default 'button,'" said one banker. "What is the purpose of all this talk out of Washington?"

Much of "the talk" of late seems to be coming from U.S. Defense Secretary Caspar Weinberger, who is continuing to press the Reagan administration to declare the Polish debt in default. He tells associates that the government's recent decision to pay U.S. banks $71 million to cover interest payments on government-guaranteed loans to Poland is under constant review.

Agricultural Loans

Bankers in the U.S. are concerned about the word "default" popping up in headlines just as they are completing work on an agreement to restructure the $1.3 billion in private debt that came due in 1981. Restructuring is contingent on Poland's completion of the payment of the $500 million in interest due last year. At least $200 million of the interest has been paid and bankers who met with Polish officials last week say they are "optimistic" that the balance will be paid by mid-February.

The Washington default debate began last week when the Agriculture Department notified 10 U.S.-based banks that the government would pay the $71.3 million in interest and principal payments due this month on U.S. government-guaranteed food-buying loans that total $885 million. The loans constitute a small portion of the total $1.6 billion the U.S. government has in loans outstanding to Poland. About $1.2 billion of those loans were made to Poland by banks, but guaranteed by the government.

The government-guaranteed loans aren't part of the $1.3 billion that U.S. banks have loaned privately to Poland. Total loans to Poland are estimated at $26.5 billion; $16 billion from Western banks and $10.5 billion from Western governments or guaranteed by them. Most of the official debt was rescheduled last year.

U.S. bankers are afraid that raising the prospect of default—even for a relatively small part of the total debt—may cause other Western bankers to panic. Most syndicated loan agreements contain "cross default" provisions that require all debts of a single borrower to be called due immediately if one debt falls into default.

"The confusion is bad," said one banker. "A Canadian banker called this morning to yell at us 'why are you doing this?'"

Mr. Weinberger is said to favor default because he believes declaring Poland in default would pain the Soviet Union by hurting the ability of Moscow and Soviet satellites to secure credits from Western banks. But, said Stanislaw Wellisz, chairman of Columbia University's economics department, default also could do grave damage to the Western banking system. "Poland itself going bankrupt isn't skin off anybody's back," Mr. Wellisz said. "But if it starts a chain reaction, it would cause enormous problems."

'Technical' Default Seen

Mr. Wallisz argues that the U.S. government's payment of the interest on the agriculture loans places Poland in "technical" default, as Poland wasn't able to pay the banks. The banks, however, prefer to view the loans as indirect loans to the U.S. government, which designated the money for Poland. "The banks never considerd this a Polish loan, but considered it a U.S. government risk," said one banker.

The bankers would like to cool discussion of default because they are much more concerned about getting their money back than about the intricacies of U.S.-Soviet foreign relations. Their attitude seems to be that, if Washington officials would keep quiet, the bankers could work something out with the Poles, just as they have rescheduled debt in Brazil, Zaire and other troubled parts of the world.

Although most banks have put their Polish loans to the "nonperforming" category—Interest isn't added to income until it is actually collected—few, if any, have actually written off the loans, said Martin Mertz, a partner at Peat, Marwick, Mitchell & Co., the accounting firm.

ESSAY

Default Is Reagan's

By William Safire

WASHINGTON, Feb. 4 — With all due solemnity, the White House press office has declared that the memo quoted in this space a few days ago — revealing national security adviser Clark's order to secretly circumvent regulations requiring that Poland be placed in default — was a leak of classified information, subject to the latest lie-detector rules.

This is an illustration of the arrogance of ignorance. Mr. Clark evidently thinks that his power to stamp "secret" on documents affecting national security extends to documents that are merely politically sensitive. By confusing what is genuinely secret with what is politically embarrassing, he abuses his power to classify.

For example, his order to protect Poland from normal default procedures was passed along to at least seven major American banks at noon Friday of last week. The Polish junta was promptly informed; the West German banks were notified; the Kremlin knew all about it. The only people not in on Mr. Clark's "secret" was the American people, whose tax money was being used to make good Poland's debt.

Moreover, Mr. Clark's improper use of his classification power could have made it possible for bank insiders to benefit from information denied to the investing public. The $71 million payment was good news for worried bankers; perhaps bank stock activity was wholly unrelated to this development, but the Clark abuse of secrecy made a mockery of S.E.C. "full disclosure" requirements.

The abuse of the classification power was compounded by the cover-up that followed. A party line was propounded at State that turned truth on its head: the cave-in to the junta's financial needs was described in testimony to Senate Percycats as a triumph of toughness. Default, went this Orwellian argument, would let the debtor "off the hook"; only by preventing default, insisted the Secretary of State, could we recover our money.

In the case of sovereign nations, that alibi is palpably false. Countries are not corporations with limited liability; when Poland defaults, it must make good on its debts before getting credit again. The same with Rumania, next on the Clark-Haig list for largesse. Default is sustained and serious pressure, and is not relief from pressure. Nor are we trying to recover money; we are trying to end martial law. The Reagan Administration is deliberately misinforming American taxpayers on this at great risk to its own credibility.

William Clark, hailed as a problem-solver, is thus creating great problems with his secrecy-sycophancy and alibi-cooking. For another example, take the case of William Van Cleave, a long-time policy adviser to candidate Reagan.

The outspoken Mr. Van Cleave was denied a job at State by Haig détentenik and shut out of Defense by Frank Carlucci, the lie-detector king. As a sop to hard-liners, the campaign deputy to Richard Allen was named to head the advisory board on arms control, even after he made clear in writing he would continue to dissent on the MX decision.

This week, Mr. Clark called Mr. Van Cleave into the White House and said that even the sop would be denied. "The vote was 3 to 1," sympathized the new national security adviser. It seems that Messrs. Baker, Deaver and Meese — there's a bunch of foreign policy experts — had opposed Mr. Clark on the nomination. Soft-liner Percy's opposition turned out to be more important than hard-liner Eugene Rostow's support. Strangely, Ronald Reagan was never asked to cast a vote.

To conservatives, Mr. Clark put forward the alibi that only Mr. Van Cleave's publicly expressed dissent to MX blocked him from the post he had afterward been promised. That is demonstrably false, but as in the case of the Orwellian explication, Mr. Clark sticks to his story and further erodes his credibility.

What is Bill Clark's game? By pandering to the President's irritation with dissenters and whistle-blowers, he undermines the tottering troika; by tolerating the humiliation of Mr. Van Cleave, he gains the chance to substitute Donald Rumsfeld in that slot and thus to send a chill through Al Haig.

But he is not knowledgeable enough to take charge himself; no interviewers are permitted to probe his thoughts, thereby to suggest that still waters may run shallow. Why, then, is President Reagan bringing Mr. Clark along so fast?

My guess is that the President wants an amiable no-liner to make peace between the high-riding détentenliks and the gloomy hard-liners at Defense, so that he can continue to concentrate on those domestic challenges that interest him most. Next year, he may figure, will be time enough to bring in a second wave of foreign policy makers.

What a mistake. Americans threw out Jimmy Carter because they believed him to be uncertain and impotent on the world stage. Next year will be too late for the creation of a coherent foreign policy. Default, dear Brutus, is not in our advisers; but as abuses grow and alibis fly, the blame is placed in the Oval Office.

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Sunday, February 7, 1982 THE WASHINGTON POST

George F. Will

No, It Would Only Hurt Some Foolish Banks

Everyone needs a hobby, and Teddy Gleason's hobby is stiffening U.S. foreign policy. He is head of the International Longshoremen's Association, and if the Reagan administration will not seriously restrict trade with the Russian and Polish regimes that are brutalizing Poland's labor movement, Gleason's men may do it, as they have before.

Gleason's foreign policy would be a distinct improvement on the government's. The government has paid $71 million to U.S. banks in lieu of interest payments Poland owes on loans the U.S. government guarantees. The payment was contrary to the law, which requires prior notice of default. Indeed, the purpose of this surreptitious payment was to prevent Poland from being declared in default, which would disrupt East-West trade and efforts to resuscitate detente.

"The United States," says Secretary of State Alexander Haig, "has made it clear that we will not do business as usual with either Poland or the Soviet Union while repression in Poland continues." Indeed, it is highly unusual to ignore U.S. law in order to subsidize Poland's martial law. To do otherwise, Haig says, would "bring down the temple of Western unity." Temple? All that would be brought down would be the earnings of some foolish bankers.

Eastern Europe's economies, which help sustain Russia's war economy, have received Western loans four times the value of all American aid to Western Europe during the Marshall Plan. Russia is so pressed for hard currency it is asking Japanese and West German companies to stretch out payments for goods shipped to Russia. Yet, as The Wall Street Journal says, the administration is "slipping into tacit collaboration with martial law by making it easier for the Soviet bloc to finance repression."

"It is highly unusual to ignore U.S. law in order to subsidize Poland's martial law."

Even before the $71 million payment, administration policy regarding Poland was dismally congruent with the general Western response, which The Economist magazine says will be remembered as the Great Handwringing of 1981-82. Democrats are noticing the opportunity to pluck from the administration's palsied grasp the falling flag of national honor, and to do so by opposing bankers on behalf of a large ethnic group.

Haig has had his way with the U.S. response to Poland's crisis and has become a hostage to fortune. He says the crisis has just begun and America must hold all serious measures in reserve for when the going gets rough. But what additional suffering by Poland could provoke action from people who worship at the "temple" of allied unity?

In Cuba, Russia long ago repealed the Monroe Doctrine and now, with the recent arrival of heavy bombers, advanced fighters and 63,000 tons of war material, it is shredding whatever is left of whatever agreement was reached at the end of the missile crisis 20 years ago. Haig is adamant, and correct, concerning the need for difficult decisions about El Salvador and the source of much other violence, Cuba. But he seems oblivious to certain problems inherent in the conduct of foreign policy in a democracy—oblivious to the practical consequences of symbolism, and to the demoralizing symbolism of America's policy regarding Poland.

Always, but especially when the president is preoccupied with domestic policy, the nation needs a secretary of state with some of Dean Acheson's attributes—someone articulate, intellectual, elegant, ironic, at ease with himself, and justifiably confident of his ability to argue America's case before skeptical elites at home and abroad. The Achesonian combination of attributes is rare, but Haig's lack of them is a problem compounded by a policy toward Poland that is certain to confuse and paralyze the nation's will. In the early 1970s, the rhetoric and other atmospherics of detente—the "end of the Cold War," "an era of negotiation, not confrontation," accords on "principles of conduct"—subverted public support for diplomatic and defense measures arduous enough to prevent detente from becoming what it became: a recipe for American retreat and an incitement to Russian expansionism. Haig then understood the problem and was a corrective force.

Today, administration policy regarding Poland is generating similar confusion and lassitude that will color defense and foreign policy debates generally. Haig argues that paying Poland's interest charges is really the "tough" policy because it keeps Poland under the burden of debt. That argument is entertainingly brassy, but it is too clever by half, which means it is not clever at all. Even if it were true, it would be politically unwise.

Someone who argues that subsidizing Poland's generals is toughness will find that, when he turns to talking of other, more recognizable, forms of toughness in Central America, the public is not deferential, or comprehending, or even attentive.

THE WASHINGTON POST, SUNDAY, FEBRUARY 7, 1982

George W. Ball

Default Would Wreck the Western Alliance

How should the Reagan administration react to growing internal pressures for the United States to declare Poland's debts in default?

Our country has so long regarded itself as the leader of the Western Alliance that many of us take for granted the commanding authority of our official pronouncements and reactions; yet, on any principle of equity, the parties with the most to lose should have the largest vote in shaping a concerted Western response. In respect to the Polish debt issue, America is a junior partner, since the main burden of a declared default would fall on our European allies. Poland owes four nations of Western Europe—West Germany, France, the United Kingdom and Austria—official or private debts amounting to $10.6 billion; the comparable figure for the United States is $3 billion. Even more pertinent, commercial banks of those four countries hold Polish debt unguaranteed by governments amounting to $5.5 billion as compared with $1.3 billion held by American banks.

Thus U.S. banks could easily absorb a Polish default but European banks, already suffering from severe depression, could incur heavy losses. The non-guaranteed Polish debt exposure of the big German trade union Bank fur Gemeinwirtschaft amounts to 40 percent of its total net worth, while Germany's Commerzbank (one of the "big three") is exposed to the extent of 24 percent of its net worth. Austria would be even more critically shaken by a declared default since its banks and government hold 6 percent of Poland's total debt to the West.

But in the view of some Americans, Poland's current credit plight is merely the result of the inordinate greed of our Western allies and their dangerously soft line toward the Soviet bloc. "Why," they ask in the song-writer's plaintive words, "can't the others be like us?" Such parochial self-righteousness, however, ignores distinctions of both geography and history. It overlooks the fact that Poland is still in spirit and tradition a Western country; to French and Germans and even British, it is still part of Europe. The Poles and their Comecon neighbors remain Europeans even though encaged by an Iron Curtain. Over the centuries the flow of goods and capital between Eastern and Western Europe has been a good part of the continent's economic life, and, especially during the period of detente, habit, tradition and compassion triumphed over artificial, brutally enforced, political barriers.

Thus Western Europeans would bitterly resent any attempt by the United States to destroy their trade with the East, which has been integrally built into their economic life, while the West Germans would be deeply grieved by any threat to the arrangements they have painfully developed for ameliorating the hardship of divided families in a divided country. Not only would they refuse to join in any American-sponsored economic quarantine, but they could never forgive us should we—in pursuit of an ideological objective they regard as self-defeating—precipitate a banking crisis in the soggy economic climate they already blame on America's monetary policies. They would see such a destructive enterprise as final confirmation of their already dark suspicions that we, ethnocentric Americans have become ever eager to strike a righteous pose at Europe's expense.

The Reagan administration, narrowly avoided falling into the [illegible] American

banks should not be required to declare a default on the Polish debt in order to receive reimbursement from the Commodity Credit Corporation on its guarantee. But that decision was, as the Duke of Wellington said of Waterloo, "a close-run thing" and, in this case, far from definitive. Secretary of Defense Caspar Weinberger and his cohorts are now threatening to force a reconsideration. They seem oblivious to the fact that an American unilateral action to declare a default would go far to wreck the alliance; nor do they seem to care that it would constitute a cruel slap at the already beleaguered Polish people for whom the resultant drying up of credits (including normal trade credits) would mean near-starvation during the bleakly cold Polish winter.

Even if the desperate Polish situation can be resolved without invoking the machinery of default, that does not mean that the Soviets and their satellites will be exempt from financial strain. The Comecon nations are all beginning to suffer from the slowdown in Polish productivity and the production shortfalls of Polish industry and agriculture, while Poland's economic troubles are curtailing Western credits to the whole Comecon bloc.

The total Soviet financial system is [illegible] already under pressure. The U.S.S.R. suffered a $6 billion current account deficit last year, and its satellites will probably incur an additional $6 billion or $7 billion deficit with Western Europe this year; they are hoping to restore their hard currency reserves largely by the shipment of gas through the projected pipeline that the Reagan administration is now frantically trying to block. The Soviets have been drawing down deposits in Western banks and selling gold. They are likely to react to any further financial pressure primarily by impoverishing the Polish people.

The only issues so far seriously discussed are how to handle the carrying charges on Poland's debt for 1981 and 1982. But, as the experts well know, a more difficult problem is our attitude toward new credits (amounting to $4 billion to $6 billion during 1982) required to support economic life at anything like tolerable levels and permit the rebuilding of the Polish economy.

Its decision on that issue will critically test the administration's fundamental strategy for dealing with the Soviet Union, and it is well that the issue be sharply drawn. On one side will be those who would continue the general line of policy we have pursued ever since the early thawing of the Cold War a decade ago. In general, we have favored measures that would weaken the Kremlin's hold over Eastern Europe and drew its imprisoned peoples more tightly into the West. But now we are hearing the angry voices of the hard-line conservatives (the neo-isolationists) arguing instead for a reversion to the most primitive strategy of the Cold War—that we insulate the Soviet power system, strengthen its prison walls and seal off both oppressor and victims hermetically.

The central thesis of this group is that we should use the Polish debts to punish the wicked Soviets. Felix Rohatyn has lent his support by advocating that we declare "Poland bankrupt" and thus "put the burden of the Polish economy squarely on the Soviet Union," and, for reasons that pass all understanding, even Weinberger seems to have joined the clamorous mob.

One of the principal [illegible]

that a Soviet government short of capital might have to curtail its military expenditures, but that is pure speculation. The more likely Soviet reaction would be to starve its own people while strengthening the political clout of a military sector already gaining alarming influence.

But that logic escapes the most fanatical and vociferous hard-liners who are eager for confrontation—tending to confuse vindictiveness with policy and to derive their most exquisite pleasure from putting an indiscriminate thumb in the Soviet eye. To them the East-West struggle is a religious war. Some are even bemused by the fantasy that harassing the Kremlin will contribute to the dissolution of a Soviet Empire that, they wishfully argue, is already in an advanced state of decay. When our friends across the Atlantic disdain such a crusade, the hard-line conservatives respond: "So much the better; America can act more freely if we need no longer have to compromise with effete allies." That is a central tenet of the isolationist credo.

Luckily for our republic and the peace of the world, the great bulk of Americans are not ideologues; they are practical men and women who see little virture in hectoring the Soviets just for sport. They do not wish to increase Polish suffering (one should not kick one's friends when they are down even for ideological reasons) nor do they want our country to be isolated or our European friends left alone to make their own separate accommodations with Moscow. Finally, they have no desire to increase the polarization of a world already at odds with itself.

So one can still hope that, once they are informed of the facts and their implications, they will recognize that we can gain nothing by helping to precipitate a world financial stringency that would blight both West and East, and that no useful purpose could be served by measures that would only further grind down the Poles. Not only would such measures be out of character for America and imprison Poland more hopelessly in the suffocating Soviet system; they would also provide the Soviets with a powerful propaganda weapon. "The greedy Western capitalists," so the Kremlin would tell the Poles, "are doing what they always do: using usury to starve you. Under their corrupt system, they care only for money." To a people suffering bitter hardship during an icy Polish winter, what could be more persuasive?

But if we are to avoid using Comecon's capital plight in a way that would increase the forced unity of the Soviet bloc, could we not still use it to gain help for the Poles? Assuming that we and our Western allies could agree on a negotiating strategy, should we not delicately undertake some quiet exchanges both with the Jaruzelski regime and with Moscow, presumably through an Eastern European intermediary? The Western nations could indicate their willingness to provide continuing limited help to assist Poland's extrication from its financial predicament in return for a visible Soviet contribution to the Polish people as well as visible measures to ameliorate repression and permit the Poles greater individual freedom. Quiet diplomacy is a hard discipline for a public such as ours, but it is far better than bluster and meaningless public threats.

The writer was undersecretary of state from 1961 to 1966.

Gov't to Repay Poles' Debts to US Banks

Journal of Commerce Staff 8 Feb 81

WASHINGTON — The Reagan administration intends to keep repaying U.S. banks for Commodity Credit Corp.-guaranteed debt due to them from Poland.

"Maximum pressure," an administration source said Friday, "can be put on Poland by insisting on repayment rather than declaring a default now. A declaration of default might be used by the Polish government as an excuse to relieve itself of its obligations to make repayments."

The administration already has agreed to repay private banks $71 million in Polish debt that had come due last month. As other U.S. government-guaranteed Polish debt comes due, the administration will similarly repay the banks, officials said.

About $500 million to $700 million in such repayments are due this year. Altogether, there is outstanding $1.9 billion in U.S. government-backed financing to Poland coming due over the next three years. Poland also owes private U.S. banks $1.3 billion in unguaranteed loans.

Officials expressed surprise Friday over the furor last week surrounding the government's $71 million repayment. Last year, they said, the government's Polish debt repayments to U.S. banks totaled $340 million.

The difference, however, is that those repayments came before the Polish government's establishing martial law.

The U.S. government's repayments, an administration spokesman said, "in no way relieve Poland of [illegible] of its obligations. The only differe[illegible] now is that Poland owes the mone[illegible] the U.S. government instead of [illegible] banks." He said that "we will [illegible] everything possible to collect it."

For the United States to declare Poland in default would achieve little, an administration source said, since their are practically no Polish assets in the United States to seize.

This year, about $10 billion of the $26.5 billion in Polish debt to the West will come due, it is estimated. Officials discount the Soviet Union's financing such a sum. The theory that Poland is under a Soviet financial "umbrella" is just theory, a U.S. official said.

About 90 U.S. banks reportedly have loans outstanding to Poland, but only about 20 have "sizable" amounts on their books.

A Senate Appropriations subcommittee is scheduled to delve into the administration's handling of the Polish debt at a hearing Tuesday.

Wall Street Journal, February 9, 1982

De-faulty Logic on Poland

The Reagan administration is resorting to twisted logic to defend its financial bailout of Poland's military dictators. Assistant Treasury Secretary Marc Leland said last Friday that declaring Poland in default of its loans would give its leaders an excuse to ignore its financial obligations. "The President has decided that maximum pressure can be put on Poland by insisting on repayment rather than declaring a default now," Mr. Leland said.

"Maximum pressure," we take it, consists for example of having U.S. taxpayers foot the bill for Poland's loans under the Agriculture Department's Commodity Credit Corp. The administration plans to pay $71 million to U.S. banks for Polish CCC loans that are already overdue. The U.S. government last year paid U.S. banks $158 million in guarantees on rescheduled Polish debt. Poland still has over $1.6 billion in outstanding CCC loans, some $300 million of which is due this year.

It now turns out that the administration's CCC decision is also of doubtful legality. The Capital Legal Foundation has developed a brief that the decision to repay the loans without a formal declaration of default violates the CCC's own rules and regulations. The rule required banks to first give notice of nonpayment, which might trigger the cross-default provisions in other loan agreements, and then for the government to confirm the finding before any government payment.

These rules were not followed in the case of Poland. Nor did the administration follow the established procedures for changing the rules, which provide that it must either publish the changes in the Federal Register and allow time for public comment, or specifically declare an emergency and explain why. The CCC of course defends its interpretation of the law, but the banks themselves are pondering the legality of the unorthodox arrangement, as well as certain CCC changes in interest provisions, before deciding whether to accept the money. They have until Feb. 13 to decide.

Contrary to putting "maximum pressure" on the dictators in Warsaw and Moscow, the administration's actions permit the Communist bloc to escape—for at least a time—the harsh financial consequences of Poland's de facto default. A declaration of default would put intense financial and political pressure on the Communist bloc. Polish trade would probably come to a standstill, at least until a strict repayment plan was agreed on. Bankers would be forced to look more skeptically at all East bloc loans, depriving the Soviet economy, and indirectly its military machine, of the kind of infusion of credit it has enjoyed the last decade.

While the Reagan administration is reluctant to take such a strong step, several members of Congress are not. Senator Patrick Moynihan yesterday introduced a bill to declare Poland in default of all of its loan obligations to the U.S. Today Sen. Moynihan and Rep. Jerry Lewis plan to introduce floor amendments to a $5 billion supplemental appropriation for the CCC requiring the agency to abide by its own rules and to receive default notices before any payments are made on Poland's debt.

Thus Congress will have its chance to be heard. Perhaps it will have the courage of Mr. Reagan's convictions.

The Wall Street Journal
February 19, 1982

AFL-CIO Council Backs Soviet Embargo, Declaration Poland Is in Default on Debt

By a Wall Street Journal Staff Reporter

BAL HARBOUR, Fla.—The AFL-CIO's executive council, preparing for today's visit from Secretary of State Alexander Haig, officially called for tougher U.S. actions to protest the imposition of martial law in Poland.

The 35-member council, here for its winter meeting, urged the Reagan administration to back up its "tough talk" with a full trade embargo against the Soviet Union and a declaration that Polish banks with overdue debt to Western banks are in default. Although AFL-CIO President Lane Kirkland and other labor leaders have called for these steps since martial law was declared in Poland in December, this was the first time the federation's ruling executive council formally endorsed the measures.

In a statement, the council noted that President Reagan, in announcing certain sanctions last month, said that further actions would be taken if the situation in Poland didn't improve. The council said, "The President hasn't kept his promise. He has backed away from the two strongest actions that remain open to him—imposing a trade embargo on the Soviet Union and declaring the Polish debt in default."

The council said that calling in Polish debt would "dry up the flow of easy credit to the Soviet Bloc," thereby disrupting Russian military and economic plans. Mr. Kirkland charged that President Reagan hasn't taken this step because of the "influence of the banking community."

At his news conference in Washington yesterday, Mr. Reagan argued that default would merely absolve Poland of its obligation to pay debts to the West and make it more dependent on the Soviet Union. At the same time, he said, "default would mean great financial hardship" for many in the West.

But the President said that the administration could use default "if it becomes a useful alternative," and he insisted that he hasn't decided whether the U.S. will pay off more rounds of overdue guaranteed Polish debts. The President also reiterated that if he ever called for an embargo it would be an "across-the-board embargo," rather than a narrow grain embargo that would penalize only farmers.

The council's actions yesterday demonstrated its alienation from the Reagan administraion, which it has repeatedly attacked during this meeting. The AFL-CIO has joined liberal groups in criticizing the recent cuts in tax rates that it contends favor the rich, and the administration's proposed budget slashes in social programs. Yesterday, the council formally joined Mr. Reagan's conservative critics who are calling for a harder line against the Soviet Union.

In a further effort to pressure the administration, the council invited a member of Solidarity, the Polish trade union, to attend today's session with Secretary Haig. Madga Wocjik, deputy director of the Plish union, addressed the council yesterday to thank the AFL-CIO for its support. The federation has raised about $300,000 for Solidarity.

Miss Wocjik, who left Poland before the military crackdown, carefully avoided criticizing U.S. policy in a conversation with reporters.

In another action yesterday, the council was sharply critical of the "New Federalism" program, Mr. Reagan's plan to return responsibility for many domestic programs to the states. The council called the plan "an ill-conceived scheme to reduce anticipated huge federal budget deficits while neglecting the nation's most fundamental needs."

... FRIDAY, FEBRUARY 19, 1982

For a Broader Western Strategy

By Zbigniew Brzezinski

Continued and even worsening repression in Poland is bound to damage the East-West relationship. The United States is committed publicly to further sanctions if the situation in Poland does not begin to improve. Moreover, almost every aspect of the American-Soviet relationship remains frozen, and both sides are beginning to perceive each other with increasing antagonism.

Tensions in the Middle East, growing conflict in Central America, the increasing arms race all create a fertile setting for hostile confrontation. Both sides are becoming prisoners of a dangerous dynamic, with the Soviet-inspired suppression of Poland serving as a catalyst for escalating enmity. In brief, we may be at a critical turning point in the American-Soviet relationship.

There have been two such turning points: the years between 1946 and 1948, and again between 1959 and 1962. The mid-Forties saw the beginning of the Cold War, which then endured for approximately a decade and a half. The late Fifties and the early Sixties saw the beginning of detente, which endured for approximately two decades. We may now be at another historic crossroads, with the events in Afghanistan of late 1979 and in Poland of late 1981 reigniting the Cold War—but in a significantly different international context.

Conditions in Europe are moving beyond the post-World War II arrangements and states of mind. Poland is a powerful signal that the Soviet bloc is starting to disintegrate. Even Soviet-inspired repression cannot hide the fact that the Soviet international system has become antiquated, economically inefficient and unresponsive to political aspirations.

At the same time, the structural crisis of the Soviet system is matched by a progressive dilution of Western cohesion and perhaps even by the fragmentation of Western unity. The West is divided in its perceptions of geopolitical reality and in its strategic assessments. What is happening in Germany may not involve so much a wave of pacifism or of neutralism as a resurfacing of the more traditional Eastern orientation in German nationalism, which in some respects is older and more established than the Western orientation associated with the era of Adenauer. This is the deeper meaning of Chancellor Schmidt's initial endorsement of the imposition on the Polish people of Soviet-style dictatorship as "necessary."

Dangerous Consequences

Moreover, to make matters even more ominous, it is quite possible that the processes of fragmentation in the East and in the West will not be synchronous but sequential. The suppression of Solidarity in Poland might revitalize the increasingly sterile and decaying Soviet political system. That system is becoming petrified, but suppression in Poland may give impetus within the Soviet Union to a greater role by the secret police and the military. The cumulative impact of that may be to arrest for a while the process of decay in the East even as the process of intensifying division in the West continues. In such a situation we could be confronted by a profound imbalance in historical processes of change in the East and in the West, with dangerous strategic consequences.

In shaping our policy we must, therefore, not only focus on what is happening within Poland but also bear in mind at all times this broader European dimension. Our response so far has been adequate but in a limited and negative sense. The Reagan administration was correct in imposing sanctions on the Soviet Union. But we also have to use whatever leverage we have to try to combine a punitive response with genuine incentives to Moscow to consider a constructive change of course.

If conditions worsen, additional steps in the economic, the strategic and the symbolic areas may become necessary. Even if it means some short-term additional inter-allied friction, the U.S. will have to impose tighter embargoes on technology transfer, focusing particularly on the economically and strategically important East-West European pipeline. Short of the grain embargo, we should consider limiting or prohibiting the sale of phosphates to the Soviet Union, since that does bear on Soviet long-term agricultural planning. The President can invoke the International Economic Emergency Powers Act, limiting imports from the Soviet Union. Finally by mid-March the time will come to face up to the question of default if there is no progress in Poland. Otherwise the U.S. and the West will be subsidizing not only an oppressive but an increasingly threatening Soviet system.

NATO and the Warsaw Pact are products of conditions in the late 1940s and early 1950s. It is time to consider some progressive adjustment in the nature of the two alliances...

For the time being, it is my view, unlike Henry Kissinger's, that arms control talks with the Soviets should continue. In fact, they are needed even more when our relations with the Soviets are worse than when they are better. In addition there is the probability that the suspension of theater nuclear force (TNF) arms control talks would result in no TNF deployment in Western Europe, since the arms control talks on this subject are to some extent a political sop to the West Europeans to obtain their support for TNF deployment. But if the situation should worsen, and especially if the Soviet involvement in Polish suppression should mount, it will become futile to continue such talks. Indeed both arms control negotiations and the grain trade are likely victims of a reignited Cold War.

Finally an important symbolic step should be taken; The U.S. should dissociate itself from the legacy of Yalta. To most East and West Europeans the Yalta agreements are symbolic of American-Soviet collusion to divide Europe. It should be made clear, with Europe no longer prostrate, that the notion of an American-Soviet condominium has no historical validity. Soviet sensitivity on this point indicates how symbolically significant such a step would be. At the same time, we should remain committed to the Helsinki agreements, which guarantee existing frontiers and which give us the basis for raising the human rights issue in the East.

But all of that represents the negative side of the ledger. We need at the same time to fashion a policy that gives the Soviets an incentive to change course and that increases the probability that the West Europeans will support us. Here, too, economic, security and symbolic considerations need to be included. First, the administration should revive President Reagan's announced willingness to consider a larger program of economic aid to Poland, if there is reconciliation within that country. The West Europeans should be invited to join in such a comprehensive economic package, and this is an area in which they are likely to be cooperative, given their major stake in East-West trade. The Soviet Union would also benefit, especially if improved East-West relations were to result in most favored nation status being extended to American-Soviet trade.

A Token of Commitment

Second, we should make more explicit our willingness to engage in comprehensive arms control talks. The time has come for the administration to put on the table its proposals regarding revision of SALT II as a token of its serious commitment to the comprehensive process of arms control.

Finally and most important, we need to ask ourselves whether in every respect every arrangement pertaining to the internal character or to the relationship between the two alliance systems in Europe is still historically valid. Both NATO and the Warsaw Pact are the products of conditions in the late 1940s and early 1950s. They endured largely unchanged during the next two decades of detente. The time has come to consider some progressive adjustment in the nature of the two alliances and in the relationship between them. Though it is premature to make a concrete proposal or to lay out a blueprint, it is appropriate to note that some of the ideas advanced at one time or another by Charles de Gaulle, by Anthony Eden and by Polish Foreign Minister Rapacki may now be historically timely.

In brief, the time has come to put on the table some proposals regarding balanced military disengagement, neutral zones and atom-free regions, to promote peaceful change both in the East and in the East-West relationship. Such a comprehensive Western initiative should be based on the recognition that the shaping of a pluralist Europe has to mean some alteration in both American and Soviet military presences. What may have been premature in the late 1950s or early 1960s may be timely now.

So far, our policy is a reaction, reflecting a sense of moral outrage, which I share, and with its cutting edge directed at Moscow, which I fully endorse. But neither political reaction nor moral outrage is the same thing as a comprehensive strategy. A broader approach is needed to shape both a better Europe and a healthier American-European relationship.

Mr. Brzezinski was National Security Adviser in the Carter administration.

4 THE WALL STREET JOURNAL, Wednesday, February 24, 1982

Reagan's Opposition to Declaring Poland In Default Is Forcefully Defended by Aides

By Gerald F. Seib
Staff Reporter of The Wall Street Journal

WASHINGTON — Despite obvious congressional skepticism about U.S. policy on Poland, top Reagan administration aides aren't giving any signs that the White House will change its opposition to declaring Poland in default.

Officials from the State and Treasury departments forcefully defended the administration's position before the Senate Banking Committee yesterday. Declaring Poland in default of U.S. government-backed commodity loans only would give the martial-law government there "an excuse to keep from paying even the small amounts which it is presently paying," said Beryl Sprinkel, Under Secretary of the Treasury for monetary affairs.

As President Reagan did at a news conference last week, the administration officials yesterday said that default could be used to pressure Poland later. But their language suggested the administration isn't inclined to change course.

"By adhering to a policy of pressuring the Poles for repayment while not providing any new credits, we can perpetuate a situation that hurts the Polish regime," Mr. Sprinkel said. "In fact, declaring a default now could make things easier for the Polish regime."

Conservatives Critical

The administration has been criticized roundly by conservative commentators and some lawmakers for offering to make payments on government-guaranteed loans to Poland without first requiring the banks to declare Poland officially in default. Proponents of default assert that a default declaration would prompt lenders to dry up Western credit to all Soviet bloc nations, which would force them to scale back their military outlays.

But Mr. Sprinkel argued that credit from the West largely has dried up anyway because of the poor financial condition of the Soviet bloc. So, even though Poland is paying only small portions of its debt, he said, it is sending out more money to the West than it is taking in.

The administration's arguments didn't seem to convince Senators at the hearing, though. They worried that failure to declare default was a sign that the U.S. wasn't tough enough with the Polish regime or its backers in the Kremlin.

Sen. Jake Garn (R., Utah), the panel's chairman, complained that "we don't really get tough" with the Soviet Union for its role in Poland or its occupation of Afghanistan.

New Resolution Promised

Similarly, Sen. Robert Kasten (R., Wis.) issued a statement contending that U.S. threats to use economic sanctions against adversaries have lost their credibility. "A declaration of Polish default would help restore that missing credibility," he said.

Sen. Kasten promised to continue pushing a congressional resolution calling for default. When he brought such a resolution to a Senate vote earlier this month, it didn't pass, but got 39 votes.

Backers of default got some new ammunition for their battle from a former Polish official yesterday. Zdzislaw Rurarz, former Polish ambassador to Japan who defected to the U.S. after the imposition of martial law, told the panel that he favors default. Declaring default would "make a point" of the failures of Poland's socialist economy and give a morale boost to opponents of the martial law regime, he argued.

But Lawrence Eagleburger, Under Secretary of State, argued that the U.S. should keep credit channels open because it may want to resume lending if Poland switches direction and ends repression of workers. He didn't offer any hope that would happen soon, though.

Other officials are making it clear that continuation of martial law in Poland will affect the administration's willingness to enter new talks to control strategic nuclear arms.

Rostow's Views

Eugene Rostow, Director of the Arms Control and Disarmament Agency, told reporters this week that the U.S. will have worked out its negotiating position for new strategic arms talks with the Soviet Union in two to three weeks. It will have completed consultations with allies and be ready to begin talks in four to five weeks.

The decision on whether to open the negotiations then depends heavily on conditions in Poland, he said.

The Polish crisis hasn't stopped the talks on reducing nuclear arms in Europe that began last year in Geneva. But Mr. Rostow yesterday gave two House Foreign Affairs subcommittees a bleak report on the progress being made in those talks.

"The Soviet Union isn't convinced yet of the need to negotiate seriously," he contended. Until it does, he added, the Kremlin is likely to use the talks primarily to create tensions between the U.S. and its allies and to stall the installation of new U.S. nuclear missiles in Europe.

The Washington Post
February 24, 1982

By Yadino

Lane Kirkland

Why Not Economic War?

An American labor leader says that selfish business interests are our foreign policy problem.

The media are wrong to play up personality clashes in the Reagan team as the source of the administration's failure to project a coherent and credible foreign policy.

The problem does not lie in who reports to whom, or in the alleged idiosyncracies or turf-consciousness of the players, or in the president's preoccupation with other matters. It lies, rather, in the deep and enduring division within the Republican Party, a division that long predates Ronald Reagan's arrival in Washington.

On the one side are the true believers—principled anti-communist ideologues, including some non-Republicans now labeled "neo-conservatives." On the other side are the commercial and banking interests, whose philosophy was asserted with stunning candor by Citibank's Thomas Theobold: "Who knows what political system works best? All we ask is: can they pay their bills?"

The true believers, to their credit, know what political system works best, and they provide the administration with its tough anti-Soviet rhetoric. They had every reason to count the president in their camp.

But when push comes to shove, the priorities of business prevail, and the ideologues are shunted aside. They still write the speeches, though, which accounts for the widening gap between the president's words and his deeds.

Poland throws the problem into high relief.

Before an international audience of tens of millions, the president's speechwriters promised stronger sanctions against the Soviets if the repression in Poland were not alleviated. The repression intensified, but the bankers persuaded the president to cover Poland's debt without declaring default. Default, they warned, would disrupt the international banking system.

The Chamber of Commerce has now weighed in to protect the Siberian natural gas pipeline, which, according to Chamber President Richard Lesher, would give Western Europe "a degree of leverage over the Soviets rather than vice versa"—a fact the obtuse Russians have apparently overlooked in their eagerness to be ensnared in our web of détente. To cripple the pipeline and deny the Soviets hard currency earnings (with which to buy Western technology) would represent, in Lesher's shocked words, "a strategy of economic warfare."

Lesher would exempt European companies operating with U.S. licenses from the sanctions imposed by the president, lest we worsen "our already poor international reputation for commercial reliability." Pepsico Chairman Donald Kendall—who previously expressed admiration for Leonid Brezhnev's devotion to peace—agrees: "I certainly question whether the [U.S.] government should put its long arm into another sovereign country and force it to accept these sanctions."

The long arm of multinational corporations and banking institutions is another matter. The flow of Western credits to Poland, accompanied by demands for food price hikes and other austerity measures, was perfectly permissible. So was the flow of credits, grain and technology to the Soviet Union, alleviating its economic problems and permitting the diversion of its resources into military purposes. What is objectionable is government intervention to achieve such foreign policy goals as enforced adherence to human rights agreements.

Simply put, the business of America is business—not only at home but throughout the world—and what's good for the bankers is good for the Poles. Above all, we must safeguard our reputation for "commercial reliability"—even as Lech Walesa remains imprisoned, thousands of Solidarity members huddle in concentration camps, and the church itself is threatened. So speak the Theobolds, the Leshers and the Kendalls.

They practice a pseudo-pragmatism that perverts, even as it seems to draw upon, the American tradition. The business ethos, applied to foreign policy, favors cost-benefit analyses done on a case-by-case basis. This method obscures the large and interwoven issues that confront us.

It is plausible to argue that calling in the Polish debt would disrupt international banking (more likely, it would embarrass the bankers by forcing them to switch loans now listed as assets into the liabilities column). It is also plausible to argue that American farmers would be hurt more than the Soviets by a grain embargo (though this assumes, and then ensures, that we are powerless to discourage other nations from rescuing the Soviets).

"If our bankers and farmers have become hostages to the Soviet bloc, should we continue down the road to increasing dependence?"

But there are questions that cannot be answered by bookkeepers. If our bankers and farmers have become hostages of the Soviet bloc—the reverse of what détente was supposed to accomplish—should we not move urgently to extricate ourselves from this situation, or should we continue down the road to increasing dependence? Can we extricate ourselves painlessly, or is there a price to be paid for a misbegotten policy? If we eschew "economic warfare," what kind of war do we want, and whom will we send to fight it? Or do we conclude that we have nothing worth fighting for, that between totalitarianism and democracy no fundamental values are at stake—that, as Theobold suggests, political systems, like capital, are fungible?

Without squarely facing these issues, which transcend business calculations, we will not persuade our allies of our capacity to lead. The message we are now sending to our allies, and to the Soviets, is that we are unwilling to endure sacrifice or inconvenience to restrain Soviet lawlessness. The Republican administration's foreign policy lacks cogency because the business interests it disproportionately represents constitute the soft underbelly of freedom.

The writer is president of the AFL-CIO.

34 THE WALL STREET JOURNAL Friday, February 26, 1982

Forces Advocating Polish Default Fail To Consider Full Impact, Wharton Says

By Frederick Kempe
Staff Reporter of The Wall Street Journal

LONDON—U.S. Defense Secretary Caspar Weinberger and like-minded Washington officials still believe the declaration of default on Poland's massive Western debts might be the weapon that would best punish Poland's military rulers and their Soviet backers. But the growing consensus among financial analysts is that the weapon is more like a Pandora's box filled with dangerous world-wide ramifications.

"A lot of people haven't really thought out the consequences," says Jan Vanous, senior economist at Wharton Econometric Forecasting Associates in Washington. "Once we put Poland in default, we will put something into motion which we have no idea how to stop."

This concern prompted Mr. Vanous to write a detailed report, to be released this weekend, on the little-publicized international ripples a Polish default would set off. Two of the more interesting findings: the U.S. has more to lose than is popularly realized and the Third World could suffer even more than Poland itself.

Foreign Insight

"Rescheduling Polish debt has nothing to do with whether we like the Poles," one London bank economist explains. "We are doing it because we're afraid what might happen if we don't."

Proponents of declaring a Polish default argue that it would put the financial burden of the Polish economy where it belongs, on the Soviet Union's shoulders. This in turn would so drain the Soviets of capital that they would reduce military spending and be less capable of foreign adventurism. The secondary purpose would be to punish the Polish martial-law government.

Massive Tab

"What the proponents of the Polish default haven't made clear to the public," says the Wharton report, "is that the moment the U.S. declares default, U.S. taxpayers will immediately have to pick up a tab amounting to $2.4 billion"—$1.9 billion in government-guaranteed credits to Poland and $500 million in tax write-off claims of commercial banks.

A West European banking source also for the first time provided statistics given bankers by the Poles last summer on the portion of its Western debt that isn't guaranteed by any government—the amount banks stand to lose. It shows that U.S. banks aren't nearly as immune from financial damage as is generally thought. Of more than $7.5 billion in nonguaranteed Western loans to Poland, U.S. banks hold the second-highest amount, $1.16 billion. The West Germans still hold the most, with nearly $2 billion in nonguaranteed loans.

Mr. Vanous of Wharton says the total owed by Poland to Western governments and banks is $18.6 billion, of which $11.1 billion was lent by governments or guaranteed by them. Previous reports had placed the total Western debt at $26.5 billion, of which $16 billion was from Western banks and $10.5 billion from Western governments or guaranteed by them. Poland last year placed its total debt at $25.5 billion, including hard-currency loans from the Soviet bloc and other non-Western sources.

U.S. lenders would certainly suffer less than West Europeans. U.S. overall exposure is $3.05 billion, while Europe's is $14 billion. However, West Europeans warn that if the U.S. government decides to pull the rug out from under the rescheduling of Polish debt, the decision could backfire. For instance, if financially troubled countries where the U.S. holds the bulk of the risk—Brazil, for example—fall into trouble in the future, West European governments might be unwilling to help fend off such lending crises if the U.S. doesn't cooperate to avoid a Polish default now.

Acts as Deterrent

"Speculation about West European retaliation in the future might just be talk or wishful thinking, but the idea does act as a kind of deterrent to default now," one West German economist observes.

Ironically, Mr. Vanous of Wharton says the region that could be hurt most by a Polish default wouldn't be Eastern Europe, but the Third World. "Without intending to do so," his report says, "the U.S. declaration of default against Poland would probably create a major lending crisis in the Third World and it is actually possible that a few Third World countries might be forced into default as well."

The Wharton report cautions that by declaring Poland in default, the U.S. would be sending a dangerous signal to commercial banks world-wide that the U.S. is willing to use the default weapon to punish countries unfriendly to the U.S.

The London bank economist adds that bankers would be forced to drastically rethink all their country lending limits. "The U.S. government would be rewriting the rules of international lending," he warns.

Janos Fekete, the highly regarded president of Hungary's national bank, is worried that U.S. government officials don't fully realize the snowball effect of a declaration of default. He says the world financial community has become too interdependent for any nation to consider credits "as a certain kind of favor that can be withdrawn without pain to both sides." Observes Mr. Fekete: "Banks aren't altruistic institutions. We fight each other over 0.25% of interest. If you kill your debtors, you will kill your customers."

Bucket Brigade

He counsels the West to look at the Polish lending crisis as a fire in the house of a disliked neighbor: "I will take a bucket of water over to put out the fire even if I don't like him, because I am defending my own house from the spreading flames."

Financial analysts also think that the U.S. would lose an important political lever on future Polish events if it declared default.

Not only would Poland lose any incentive to try to service its debt (the annual interest cost alone, is said to run at $2.5 billion) but it also would have less incentive to win Western favor by liberalizing its economy. Wharton argues that sustained economic pressure is more effective because it can be adjusted to reward or punish Poland. "Default is an inflexible policy tool because it implies a policy step that isn't reversible," the report cautions.

Moreover, despite some feeling in Washington to the contrary, most West European government officials and bankers continue to believe that the West still can influence events in Poland, but only by intelligently using economic means. To use the default weapon before Poland is considered totally lost would be counterproductive, they argue.

"In short," the Wharton report says, "default may push Poland deeper into the Soviet orbit and would represent a complete reversal of a 20-year-old U.S. effort to encourage increased Polish independence from the Soviet Union."

SUBMITTED QUESTIONS

Senator KASTEN. The record will remain open for 10 days so questions submitted for the record may be answered and any additional statements the witnesses wish to include can be received by the subcommittee.

[The following questions were not asked at the hearing but were submitted for response for the record:]

Questions Submitted by Senator Kasten

Responsibility for CCC Payment Decision

Senator Kasten: Who made the recent decisions with respect to payments by CCC on an additional $71 million of guaranteed credit for which payment was due in January, 1982?

Mr. Lyng: The decision to make the January 28 offer to holders of CCC guarantees for credit extended to Poland was made by CCC. The enclosed memorandum discusses this offer and the legal basis for it.

Payment guarantees were issued from 1979 through 1981 to cover credits on terms of up to 3 years extended to Poland by private banks. When these guarantees were issued, CCC undertook an obligation to pay the holder of the guarantees if Poland failed to make payment.

CCC Payments Made

Senator Kasten: Have any such payments been made yet? (If so, to whom, how much, and when?) (If not, will any payments be made? When? To whom?)

Mr. Lyng: Under CCC's offer dated January 28, 1982, one payment of $153,882.45 was made to Bank of Boston International on February 18, 1982. Also, Continental Grain Export Corporation was paid $488,474.71 plus interest on February 5, 1982. Subsequently, Continental Grain recovered this money from Poland and a refund of this amount was made to CCC on February 18, 1982. As of April 2, 1982, no other payments have been made under CCC's offer.

Senator Kasten: To what, if any extent will this practice of CCC payments continue?

Mr. Lyng: CCC has an obligation under the payment guarantees to make payments to the holders through 1984 for credits extended to Poland if Poland fails to make its payments. With respect to CCC's offer of January 28, 1982, all holders have now accepted the offer and it will apply to all remaining payments under guaranteed credits to Poland, unless CCC exercises its right to terminate the contract at any time.

Written Communications

Senator Kasten: For the record, please provide the Subcommittee with copies of any pertinent telex-communication between CCC and the banks regarding this matter.

Mr. Lyng: Pertinent information regarding holder's of payment guarantees under CCC Export Credit Guarantee Program is enclosed.

1. CCC's offer to payment guarantee holders dated January 28, 1982.

2. CCC's extension of its January 28, 1982 offer to February 26, 1982.

3. CCC's extension of its January 28, 1982 offer to March 26, 1982.

4. Bank of Boston International's acceptance of CCC's offer.

5. Continental Grain Export Corporation's acceptance of CCC's offer.

6. Nissho Iwai American Corporation's acceptance of CCC's offer.

7. Chemical Bank's acceptance of CCC's offer dated March 11 and 12, 1982.

8. Morgan Guaranty Trust Company's acceptance of CCC's offer dated March 11, 1982.

9. Irving Trust Company's acceptance of CCC's offer dated March 25, 1982.

10. Bank America International's acceptance of CCC's offer dated March 11, 1982.

11. The Riggs National Bank's acceptance of CCC's offer dated March 26, 1982.

12. Girard Bank's acceptance of CCC's offer dated March 26, 1982.

13. European American Banking Corporation's acceptance of CCC's offer dated March 26, 1982.

14. Marine Midland Bank N.A. acceptance of CCC's offer dated March 26, 1982.

15. First Chicago's acceptance of CCC's offer dated March 23, 1982.

U.S. DEPARTMENT OF AGRICULTURE
FOREIGN AGRICULTURAL SERVICE
WASHINGTON, D.C. 20250

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203 0402 08 2-10-82

FAS:EC:POD:LTMcElvain:ejm 447-6225

FEB 10 1982
Sent Feb 11, 1982

(SEE ATTACHED LIST)

SUBJECT: CCC's Offer to All Holders of GSM-101 Assurance Agreements and GSM-102 Payment Guarantees Covering Credits to Poland

The Commodity Credit Corporation (CCC) hereby extends through February 26, 1982, the acceptance date of its offer (the "offer") dated January 28, 1982, to repurchase its outstanding obligations under the assurance agreements and payment guarantees (collectively "guarantees") issued pursuant to its GSM-101 Noncommercial Risk Assurance Program and GSM-102 Export Credit Guarantee Program regulations (collectively "regulations"), respectively, covering commercial credits extended to obligors of the Polish People's Republic (Poland).

Some holders of guarantees have questioned whether option (a) of paragraph 2 of the terms and conditions of the offer is different from the provisions of the regulations with respect to the assignment of all right, title and interest in the credit, and the manner in which collections are pro-rated between CCC and guarantee holders. It is CCC's position that option (a) is the same as the regulations with respect to this matter. In particular, concern has been expressed as to the extent of CCC's right to adjust interest rates under the last sentence of paragraph 2(a) of the terms and conditions of the offer. It is CCC's position that the right under that sentence to alter the interest rate charged from that provided in the credit extends only to the guaranteed portions of credits assigned to CCC.

This extension of time for acceptance of the offer does not affect any other provisions of the offer. Please note that interest on amounts payable by CCC under the offer will not begin to accrue prior to receipt of notices of election.

Alan T. Tracy, General Sales Manager
and Associate Administrator
Foreign Agricultural Service; and
Vice President, Commodity Credit
Corporation

FAS:POD:EC:LMcElvain:ejm:X76225:2-10-82

cc: ATracy; JRoss; GWhiteman; DBrinze; LMcElvain; LWallace; TPomeroy; DGodsey

TELEGRAPHIC MESSAGE

NAME OF AGENCY	PRECEDENCE	SECURITY CLASSIFICATION
U.S. DEPARTMENT OF AGRICULTURE FOREIGN AGRICULTURAL SERVICE WASHINGTON, D.C. 20250	ACTION: INFO:	
ACCOUNTING CLASSIFICATION: 122 2900 201 0402 08	DATE PREPARED: 2-25-82	TYPE OF MESSAGE ☐ SINGLE ☐ BOOK ☐ MULTIPLE ADDRESS
FOR INFORMATION CALL		
NAME: FAS:POD:EC:LTMcElvain:ejm	PHONE NUMBER: 447-6225	

THIS SPACE FOR USE OF COMMUNICATION UNIT

Sent Feb. 26, 1982

MESSAGE TO BE TRANSMITTED (Use double spacing and all capital letters)

TO:
(SEE ATTACHED LISTING)

SUBJECT. CCC's Offer to All Holders of GSM-101 Assurance Agreements and GSM-102 Payment Guarantees Covering Credits to Poland

The Commodity Credit Corporation (CCC) hereby extends through March 26, 1982, the acceptance date of its offer (the "offer") dated January 28, 1982, to repurchase its outstanding obligations under the assurance agreements and payment guarantees (collectively "guarantees") issued pursuant to its GSM-101 Noncommercial Risk Assurance Program and GSM-102 Export Credit Guarantee Program regulations (collectively "regulations"), respectively, covering commercial credits extended to obligors of the Polish People's Republic (Poland).

This extension of time for acceptance of the offer does not affect any other provisions of the offer. Please note that interest on amounts payable by CCC under the offer will not begin to accrue prior to receipt of notices of election.

Alan J. Tracy, General Sales Manager
and Associate Administrator
Foreign Agricultural Service; and
Vice President, Commodity Credit
Corporation

SECURITY CLASSIFICATION	PAGE NO.	NO. OF PGS.
	1	1

STANDARD FORM 14
REVISED AUGUST 1967
GSA FPMR (41 CFR) 101-35.306

14-102

TLMK WSH

TO
TLMK WSH

WU INFOMASTER 1-025793A032 02/01/82
ICS IPMWAMC WSH
ZCZC 07046 WUTELTEX NEWYORK NY 02-01 341P EST
TLX 904039 TLMK WSH
TREASURER COMMODITY CREDIT CORP
US DEPARTMENT OF AGRICULTURE
12TH & INDEPENDENCE AVE
WASHINGTON DC
RT

WITH REFERENCE TO YOUR TELEX OF JAN. 28 1982 CONCERNING YOUR OFFER TO REPURCHASE YOUR OBLIGATIONS UNDER GSM-102 COVERING COMMERCIAL CREDITS TO POLAND, WE HEREBY ACCEPT YOUR OFFER STOP
REGARDS,
MTF WINGATE, VICE PRESIDENT
BANK OF BOSTON INTL
NEW YORK
CORPROS NYK/SD

NNNN
2104 EST
0
TLMK WSH

RE GSM 102 - CORN TO POLAND

REPEATING OUR TELEX TO TREASURER OF CCC DATED JAN 29 1982

QUOTE:

TREASURER

COMMODITY CREDIT CORPORATION

U.S. DEPT OF AGRICULTURE

WASH, DC

FM NYK 01/29/82 09:33 EST KS .837.

WE ACKNOWLEDGE RECEIPT OF CCC,S TELEX DATED JAN. 28, 1982, CONTAINING AN OFFER TO REPURCHASE OUTSTANDING OBLIGATIONS UNDER GSM-102, COVERING COMMERCIAL CREDITS EXTENDED TO OBLIGORS OF POLAND.
WE HEREBY ACCEPT HIS OFFER AND SELECT OPTION 2(A). PLEASE NOTE THE ITEMS CURRENTLY OUTSTANDING ARE AS FOLLOWS, ALL COVERING SEMI ANNUAL INTEREST DUE ON THE DATES SHOWN.

GSM AGRT NO.	DUE DATE	INTEREST DUE
102-117	JAN 7, 1982 DLFS	91,691.51
~~102-118~~	~~JAN 8, 1982 DLFS 146,218.38~~	Rec'd
102-119	JAN 11, 1982	168,371.65
102-920	JAN 22, 1982	228,481.55

CONTINENTAL GRAIN EXPORT CORPORATION

~~A SLABOTZKY/ASST V P~~

NISROCK NYK

FROM NYKYU FEB-5

TO: TREASURER FEBRUARY 5,1982 TLX NO. 264

COMMODITY CREDIT CORPORATION

U.S.DEPARTMENT OF AGRICULTURE

P.O.BOX 2415

WASHINGTON D.C. 20013 (TELEX NO.89491)

RE: CCC PAYMENT GUARANTY NO. GSM-102-58

SUBJECT: CCC OFFER AS TO GSM-102 PAYMENT GUARANTEES COVERING CREDITS TO POLAND (THE ''OFFER'')

DEAR SIR:

THE UNDERSIGNED EXPORTER HEREBY ACCEPTS THE OFFER OF THE CCC DATED JANUARY 29,1982.

VERY TRULY YOURS

NISSHO IWAI AMERICAN CORPORATION

FOODSTUFFS DEPARTMENT

1211 AVENUE OF THE AMERICAS

NEW YORK, N.Y. 10036

TELEX NO. 127090 NIAC NYK

PSP.

ASCS WSH

U. S. DEPARTMENT OF AGRICULTURE
FOREIGN AGRICULTURAL SERVICE
WASHINGTON, D. C. 20250

1224336(29)
203-0402-08

January 28, 1982
Offer
X

FAS/EC/POD:LTMcElvain:jtw:1/27/82 447-6225

(SEE ATTACHED LISTING)

SUBJECT: CCC's Offer to All Holders of GSM-101 Assurance Agreements and GSM-102 Payment Guarantees Covering Credits to Poland

The Commodity Credit Corporation ("CCC") hereby offers to repurchase its outstanding obligations under the assurance agreements and payment guarantees (collectively "guarantees") issued pursuant to its GSM-101 Noncommercial Risk Assurance Program and GSM-102 Export Credit Guarantee Program regulations (collectively "regulations"), respectively, covering commercial credits extended to obligors of the Polish People's Republic (Poland).

The following definitions apply for purposes of this offer. "Obligation" is defined as a member of the series of obligations of CCC under its guarantees to pay a specified portion of a payment due to the exporter or the exporter's assignee (hereinafter the "holder" as appropriate) in the event of a default of such payment by the Polish obligor, with each obligation corresponding to a separate payment. Such obligation is outstanding if the corresponding payment has not yet been paid in full. Principal and interest due on the same date constitute one payment. All periods of time are in calendar days unless otherwise specified. "Credit" includes agreements related to the commercial letter of credit issued by the Polish obligor. The due date of an obligation's corresponding payment is that date submitted to CCC as part of the final payment schedule for the credit to Poland, including any amendments to that schedule. All interest amounts paid by CCC will be calculated on the basis of a 365-day year.

This offer is subject to the following terms and conditions:

89-938 O - 83 - 8

(1) This offer must be accepted within 15 days of the date of this offer. Acceptance will be effective for all outstanding obligations for all guarantees held by the holder covering credits to Poland until terminated as provided in paragraph 9 below.

(2) If this offer is accepted, for each obligation outstanding at the time of election under paragraph (3) below, CCC offers holders the choice of two options:

(a) CCC will repurchase the obligation at a price equal to the full amount of CCC's obligation. Repurchase of this obligation will extinguish all liability of CCC for the corresponding payment.

The holder must assign to CCC all right, title, and interest in the credit (including the right to charge interest at the rate provided in the credit for delinquent amounts) to the Polish obligor for the full amount of the corresponding payment, including any amounts not covered by CCC's guarantee. CCC will pro-rate any collections made from the Polish obligor between the holder and CCC based on the ratio of guaranteed and unguaranteed amounts of the payment. CCC may determine the terms and conditions of the obligor's repayment and may charge interest at a rate lower than the rate provided in the credit for delinquent amounts, OR

(b) CCC will repurchase the obligation at a price equal to the full amount of the principal component of the corresponding payment only. Repurchase of this obligation will extinguish all liability of CCC for the corresponding payment, including the interest component, if any.

The holder must assign to CCC all right, title, and interest in the credit (including the right to charge interest at the rate provided in the credit for delinquent amounts) to the Polish obligor for the full amount of the principal component of the corresponding payment only. The holder will retain all right, title, and interest to the amount of the credit not assigned to CCC under this option.

(3) For each outstanding obligation, the holder must notify the Treasurer, CCC, as to which option it has elected no later than 28 days after the due date of the corresponding payment or 28 days after acceptance of this offer, whichever is later, or such other date as is approved by the Treasurer of CCC. If the notice of election is not received prior to the appropriate date, CCC's obligation for the corresponding payment will lapse and all of CCC's liability under that obligation will be extinguished. The holder's notice of election may not be submitted to CCC more than 35 days prior to the due date of the corresponding payment.

(4) The holder's notice of election must be in writing and must be accompanied by the documents specified in 7 CFR 1487.8(b)(3)(i), (iii) and (iv) if the obligation was issued under GSM-101, or 7 CFR 1493.8(b)(3) if issued under GSM-102, unless otherwise agreed to by the Treasurer, CCC.

(5) CCC agrees to pay the holder of each obligation repurchased in accordance with this offer interest on the purchase price determined under paragraph (2) above. For obligations issued under GSM-101, interest will accrue beginning 31 days after receipt of the documents and notice of election that comply with the terms and conditions of this offer, or 32 days after the due date of the corresponding payment, whichever is later, and will continue to accrue until payment by CCC. Interest shall accrue at the New York Federal Reserve Discount Rate in effect on the due date of the corresponding payment.

For obligations issued under GSM-102, interest will accrue beginning one day after receipt of the documents and notice of election that comply with the terms and conditions of this offer, or two days after the due date of the corresponding payment, whichever is later, and will continue to accrue until payment is made by CCC. Interest shall accrue at the latest rate of the bond equivalent of the 52 week

U.S. Treasury bill auction average as published by the Department of the Treasury on or prior to the due date of the corresponding payment.

(6) The holder agrees, by acceptance of this offer, that the holder will not submit notices or claims pursuant to 7 CFR 1487.8 of GSM-101 or 7 CFR 1493.8 of GSM-102 for obligations whose corresponding payments are due from Polish obligors prior to the effective date of termination of the contract formed by acceptance of this offer.

(7) CCC reserves its rights to proceed against the holder and/or the exporter for breach or violation of the holder's and/or exporter's obligations or warranties undertaken pursuant to the regulations.

(8) The holder agrees to retain, for CCC audit and inspection, for three years after the expiration of the guarantee, the records and documents which had to be retained under the applicable regulations.

(9) CCC may terminate the contract formed by acceptance of this offer at any time by notifying the holder by telex or other written form. The termination will be effective for those obligations with corresponding payments due on or after the date of such notification of termination, or such later date as may be specified in such notification.

(10) Acceptance must be by telex or other written form to the Treasurer, CCC, U. S. Department of Agriculture, P. O. Box 2415, Washington, D. C. 20013. This offer must be accepted before submitting any notice of election under paragraph (3) above.

Alan T. Tracy, General Sales Manager
and Associate Administrator,
Foreign Agricultural Service; and
Vice President, Commodity Credit
Corporation

cc: LTMcElvain, TAPomeroy, RGodsey, LWallace, GWhiteman, JRoss, ATracy

LEGAL AUTHORITY FOR CCC'S OFFER OF

JANUARY 28, 1982 TO HOLDERS OF

CCC GUARANTEES COVERING CREDITS TO POLAND

On January 28, 1982 the Commodity Credit Corporation (CCC) made an "Offer to All Holders of GSM-101 Assurance Agreements and GSM-102 Payment Guarantees Covering Credits to Poland". Essentially that offer provides for the repurchase or settlement of CCC obligations arising under the GSM-101 Noncommercial Risk Assurance Program and the GSM-102 Export Credit Guarantee Program in connection with export credit sales to Poland.

As detailed below, the action taken by CCC is clearly within its legal authority and is consistent with the laws and regulations governing CCC. Because an understanding of the CCC export guarantee programs is a prerequisite to understanding the action taken by CCC on January 28, this paper first outlines those programs, then explains the January 28 offer, and finally sets forth the legal basis for that action.

THE GSM-101 AND GSM-102 PROGRAMS

General Program Structure. The GSM-101 and GSM-102 programs seek to promote exports of U.S. agricultural commodities and their products by shifting some of the risks traditionally associated with export transactions to CCC. Both programs are essentially identical in structure and operation; the major difference between them is that the GSM-101 program is limited to protecting against only non-commercial risk while the GSM-102 program covers all risks.

Under both programs, CCC promises to reimburse exporters, or the financing institutions that are the exporters' assignees, for a portion of the exporter's account receivable in the event of nonpayment by the importer's bank that issued the irrevocable letter of credit pertaining to the export sale. In return the holder of the guarantee must assign to CCC all rights in the payment that was not received. The total amount that CCC will guarantee and the portion of the account receivable for which CCC will reimburse the holder is determined by CCC in advance for each country. In the case of Poland, all of the credits covered by the CCC guarantees were issued by the state-owned central bank, Bank Handlowy w Warsawie. CCC guaranteed 100 percent of the principal amount and six percent per annum interest on these credits.

Mechanism for Payment under CCC's Guarantee. In order for the holder of the guarantee to collect from CCC on CCC's promise to reimburse the holder, the holder must first notify CCC that a payment has been missed and then file a claim together with supporting documentation. Under GSM-102, pursuant to which CCC issued approximately 60 percent of its guarantees for credits to Poland, the requirement of notice is set forth as follows:

> §1493.8 Notice of default
>
> (a) If the foreign bank issuing the letter of credit fails to make a remittance pursuant to the terms of the foreign bank letter of credit or related obligation, the exporter or the exporter's assignee shall notify CCC by phone or wire if payment is not received within 10 days of due date, or any extension thereof ....

Section 1487.8(a) of the GSM-101 regulations contains a similar notice requirement. The language of that section is as follows:

> §1487.8 Notice of default
>
> (a) If the foreign bank issuing the letter of credit fails to make a remittance pursuant to the terms of the letter of credit or a related obligation arising under the letter of credit and such default appears to

> be attributable to the occurrence of a noncommercial risk, the exporter or the assignee shall promptly furnish a written notice of default to the Treasurer, CCC ....

Under both regulations, "default" is defined as occurring when "the foreign bank issuing the letter of credit fails to make a remittance pursuant to the terms of the ... letter of credit or ... related obligation".

The purpose of requiring the holder of the guarantee to notify CCC that the foreign bank has failed to make a remittance is to alert CCC to its imminent liability for that payment and to allow it to take such actions as it considers appropriate to protect its interests. For CCC's purposes, then, this notice could have been titled a "notice of nonpayment" or "notice of overdue payment" or other similar language conveying the same idea. It is important to note that CCC's definition of default for purposes of notification under the regulations is fundamentally different from the concept of default in banking circles. A formal declaration of default in that context commonly involves triggering the penalty provisions of agreements with the debtor, including declaring the entire debt to be due and payable and increasing the rate of interest charged on the outstanding balance due. A formal declaration may also trigger efforts to seize the debtor's assets in an attempt to satisfy the debt.

CCC does not require such a declaration of default by the holder in order to trigger CCC's liability. CCC simply requires prompt notice that a payment has been missed.

Once the holder has notified CCC of the foreign bank's failure to make a payment, the holder has 30 days in which to file a claim with CCC for payment. A claim consists of a certification that the scheduled payment has not been received together with copies of the foreign bank letter of credit or related obligation, the ocean carrier or intermodal bills of lading, and invoices showing the value of the commodities exported. In addition, under GSM-101 the holder must furnish a copy of the export credit sales contract, and under GSM-102 the holder must submit the instrument transferring the holder's rights in the payment to CCC. CCC's obligation to pay the holder is not effective until a claim is filed. A notice and claim may be filed simultaneously. The purpose of the claim requirement is to establish a record to allow CCC to make a final determination of its liability and to furnish CCC the supporting evidence it needs to pursue CCC's rights against the foreign bank.

As a condition of paying on the holder's claim, CCC requires the holder to transfer to CCC all of the holder's interest in the payment missed by the foreign bank, including the holder's interest in the portion of that payment not guaranteed by CCC. The holder and CCC agree to divide any recoveries that have been or will be made on the missed payments by either of them between CCC and the holder based on their shares in that payment. In that manner CCC and the holder would be made whole at the same rate if and when payments are received.

CCC'S JANUARY 28 OFFER

Early in 1982, holders of CCC guarantees informally advised CCC that Bank Handlowy was missing its January payments to them. CCC remained in close communication with those holders, and as of January 28 it seemed clear that Bank Handlowy would not make its payments and that CCC would soon be called upon to meet its guarantee obligations.

CCC decided to take such steps as it could within its statutory authority to avoid the risk of Poland being formally declared in default by its creditors. Consequently, on January 28, 1982, CCC issued an offer to all of the holders of outstanding CCC guarantees covering credits to Poland. That offer provided a mechanism whereby CCC would repurchase its obligations under those guarantees on a payment by payment basis under terms which did not alter -- and in fact under one option of the offer there was the potential to improve -- the financial position of CCC compared to its posi-

tion under the payment mechanism provided in the regulations. At the same time the offer did not require the holder to file a formal notice and claim with CCC.

Specifically, CCC offered to repurchase its outstanding guarantee obligations covering missed payments by Bank Handlowy under one of two options on a payment by payment basis. The first option was and is fully harmonious with and protective of CCC's rights and liabilities with respect to its obligations under the regulations. Under the second option CCC is relieved of its obligation to cover six percent per annum interest on a payment in exchange for the holder and CCC not sharing in any recoveries either one makes. This second option, if elected by holders, could result in substantial savings to CCC. CCC concluded that it would be in at least as advantageous a position under the offer as it would be under the payment mechanism provided in the regulations.

Under both options the holder must notify CCC whether it has elected one of the options for a given payment. This provides the same notice to CCC as the notice of default required by the regulations. It alerts CCC of its potential liability and allows it to take such steps as it considers necessary to protect its interests. The holder is also required to file a copy of the foreign bank letter of credit, the ocean carrier or intermodal bills of lading, and the invoices showing the value of the commodity exported. Because the offer applies only to obligations for which the corresponding payment has not yet been paid in full, CCC is fully protected from paying out except where the scheduled payment has not been received. This requirement together with the required documentation provides CCC with the same ability to make a final determination of its liability and furnishes CCC the same supporting evidence it must have to pursue its rights against Poland as that provided by the claim requirement of the regulations.

CCC also provided in the offer that acceptance of the offer bound the holder to its terms for all outstanding CCC obligations covering credits to Poland. On the other hand, CCC was free to terminate the contract at any time. In this way CCC preserved its option of reverting to the procedures under the regulations whenever it wished to do so. At the same time, the holder is not limited to accepting the options contained in the January 28 offer, but may elect to follow the payment mechanism provided in the regulations.

LEGAL AUTHORITY

CCC was acting within its legal authority in making the January 28 offer to holders of CCC guarantees covering credits to Bank Handlowy. This conclusion is based on two elements: (1) the January 28 offer in no way alters the basic rights and liability of CCC under its obligations but instead offers a possibility of improving CCC's position concerning those obligations and (2) CCC has broad statutory authority to enter into contracts of this type for the settlement of its claims and obligations.

Rights and Liabilities of CCC. Under the terms and conditions of the offer, CCC is no worse off than under the framework established in the regulations and CCC may in fact be in a better position than it would have been had it relied solely on the program regulation framework. Under the first option of the offer, CCC's position is no different than it is under the program regulations. First, Bank Handlowy has failed to make its payments when due. As a result, it is undisputed that CCC is unconditionally obligated to pay holders the amount of their credits guaranteed by CCC, whether under the mechanism of the regulations or under the contract mechanism of CCC's January 28 offer. Second, the procedural requirements under the offer provide CCC the same protection with respect to its rights and liabilities as the procedural notice and claim requirement of the regulations.

Under the second option of the offer, to the extent it is selected by holders, CCC could be in a better position than under the program regulations in that it will not have to pay holders the six percent per annum interest guaranteed by CCC. CCC has determined that this could leave CCC in a better position than insisting on a share of any interest recovery made by a holder.

Statutory Authority. The Commodity Credit Corporation Charter Act (15 U.S.C. 714 et seq.) confers broad authority upon CCC to manage its fiscal affairs. In exercising this authority, CCC is subject to the duty to act in accordance with customary standards of prudent business management.

Section 4(g) of that Act empowers CCC to "enter into and carry out such contracts or agreements as are necessary in the conduct of its business." Section 4(j) of that Act gives CCC the power to "determine the character of and the necessity for its obligations and expenditures and the manner in which they shall be incurred, allowed, and paid." Section 4(k) of that Act authorizes CCC "to make final and conclusive settlement and adjustment of any claims by or against the Corporation or the accounts of its fiscal officers." And section 4(m) provides that CCC "[s]hall have such powers as may be necessary or appropriate for the exercise of the powers specifically vested in the Corporation, and all such incidental powers as are customary in corporations generally." (15 U.S.C. 714b.)

In making its January 28 offer, CCC was using its powers to make and amend such contracts as are necessary to the judicious management of its obligations and its power to settle its claims arising under those contracts. This offer did not affect any other obligations issued by CCC nor did it alter the GSM-101 or GSM-102 regulations. Those regulations continue to govern CCC's obligations covering debts to Poland in the event holders choose not to avail themselves of the alternative contract mechanism offered by CCC and they continue to govern any new guarantees issued by CCC.

CCC was not obligated to amend its regulations in order to make this offer. Those regulations prescribed the rules and conditions under which CCC is willing to issue its guarantees, but once issued those guarantees are contracts between the holders and CCC. Like any such contract, the guarantees are subject to adjustment by the parties in connection with the settlement of their claims and obligations. CCC's offer affected only its rights and the rights of the holders of CCC guarantees to whom the offer was made. CCC was not required to permit the general public to participate in such a settlement by utilizing notice and comment procedures to incorporate the terms of the settlement in the regulations.

In light of the broad statutory authority of the Corporation to enter into contracts to provide for the management of its claims and obligations, and in view of the manner in which CCC has exercised this authority for the benefit of CCC, CCC was authorized to make its offer of January 28, 1982.

Treasurer, CCC
U. S. Department of Agriculture
P. O. Box 2415
Washington, D.C. 20013

Dated: March 25, 1982

Subject: CCC's Offer To All Holders
of GSM-101 Assurance Agreements
and GSM-102 Payment Guarantees
Covering Credits to Poland

Dear Sir:

This confirms our telex to you of even date.

We accept the offer set forth in your January 28, 1982, and February 10, 1982 telexes, as extended through March 26, 1982, concerning the above subject.

Very truly yours,

IRVING TRUST COMPANY

By _____

Hunter D. Brown
Vice President

New York March 12, 1982

Mr. Robert A. Brammer
Treasurer
U.S. Department of Agriculture
Commodity Credit Corporation
Room 6096
Washington, D.C. 20250

Dear Mr. Brammer:

This is to confirm our cable sent to you on March 11, 1982 which read as follows:

> Quote - Subject: CCC's offer to the holders of the GSM-102 payment guarantees covering credits to Poland.
> With reference to your telex of January 28, 1982, we wish to advise you that we accept your offer of repurchasing obligations of Bank Handlowy w Warszawie S.A., Warsaw, Poland extended by us under your payment guarantee No. GSM-102-696.
>
> Since you have extended the deadline for acceptance of your offer to March 26, 1982, we assume that we will have the right to benefit from any changes or modifications you may make after the date hereof with respect to the offers you have submitted to other banks. Unquote.

Best regards.

Sincerely yours,

_____

March 25, 1982

Mr. Lester Lecompte
Treasurer
Commodity Credit Corporation
United States Department of Agriculture
P.O. Box 2415
Washington, D.C. 20013

Dear Mr. Lecompte:

BankAmerica International - Chicago Branch is in receipt of your Repurchase Offer of January 28, 1982 and subsequent amendments thereto. We are hereby notifying you of our acceptance of the offer.

We will be communicating with you later with respect to which option, A or B, will be elected for relevant maturities.

Sincerely,

March 26, 1982

Treasurer
Commodity Credit Corporation
U.S. Department of Agriculture
P.O. Box 2415
Washington, D.C. 20013

Dear Sir:

This is to accept the offer of Commodity Credit Corporation of January 28, 1982 with regard to the repurchase of its outstanding obligations under agreements issued pursuant to GSM-101 and GSM-102 Programs covering commercial credits extended to obligors of the Polish People's Republic.

In accordance with the offer, we will shortly notify you with regard to each obligation as to which option we elect.

Very truly yours,

The Riggs National Bank
of Washington, D.C.

By _____
Vice President

March 26, 1982

HAND DELIVER

Mr. Robert Brammer
Treasurer
Commodity Credit Corporation
United States Department of Agriculture
Washington, D.C. 20013

Dear Mr. Brammer:

Girard Bank hereby accepts the offer made to it by Commodity Credit Corporation ("CCC") on January 28, 1982, as amended and corrected through March 25, 1982, whereby CCC offered to repurchase, pursuant to the terms of the offer, its obligations under the assurance agreements and payment guarantees issued pursuant to its GSM-101 noncommercial risk assurance program and GSM-102 export credit guarantee program.

By letter dated as of March 19, 1982, this bank in conjunction with certain other bank participants in the GSM-101 and GSM-102 programs suggested modifications to CCC's offer of January 28, 1982. The acceptance of CCC's offer of January 28, 1982 evidenced by this letter is not conditioned upon CCC's acceptance of the modifications suggested by the joint bank letter dated as of March 19, 1982; however, Girard reserves the right to modify this acceptance to include the additional options set forth in the joint bank letter dated as of March 19, 1982 and any other changes or additions to the offer of January 28, 1982 hereafter made or agreed to by CCC if such additional options, changes or other additions are then satisfactory to Girard.

Yours truly,

William E. Van Norden
Chairman, Credit Policy Committee

TO:COMMODITY CREDIT CORPORATION

WASHINGTON, D.C.

FM:EUROP AMER BKING CORP NY DTD 3/26/82 AM

ATTN: MR. ALAN T. TRACY, GENERAL SALES MANAGER AND ASSOCIATE ADMINISTRATOR, FOREIGN AGRICULTURAL SERVICE: AND VICE PRESIDDENT

SUBJECT:CCC'S OFFER TO ALL HOLDERS OF GSM-101 ASSURANCE AGREEMENT AND GSM-102 PAYMENT GUARANTEES COVERING CREDITS TO POLAND("THE OFFER")

WE REFER TO YOUR TELEX OF JAN 28,1982,AS AMENDED JAN.29, 1982,IN WHICH YOJ OFFERED TO REPURCHASE YOUR OUTSTANDING OBLIGATIONS UNDER THE ASSURANCE AGREEMENTS AND PAYMENT GUARANTEES.

BY THIS TELEX WE HEREBY ACCEPT THE TERMS AND CONDITIONS OF THE OFFER AND CONFIRM THAT WE SHALL SUBMIT NOTICES OF ELECTION FOR AMOUNTS UNPAID WHEN DUE BY THE PRIMARY OBLIGOR, IF ANY, IN THE MANNER SPECIFIED IN THE OFFER, ELECTING EITHER OPTION A OR OPTION B FOR EACH NOTICE.

FOR AND ON BEHALF OF EUROPEAN AMERICAN BANKING CORP.
REGARDS,
JOHN R. BAER, SR.V.P.

SIG EUROP AMER BKING CORP NY CBL 72450 AM
NNNN

ASCS WSH

TO COMMODITY CREDIT CORP U.S. DEPT OF AGRICULTURE WASH. DC.
FM MARINE MIDLAND BANK NY NYC
SERIAL OURREF 266756 3-22-82

ATTN: ALAN TRACY, GENERAL SALES MANAGER AND ASSOC. ADMIN.
FOREIGN AGRICULTURAL SERVICE AND V.P.

RE: COMMODITY CREDIT CORPORATION'S (CCC) OFFER TO ALL HOLDERS OF GSM-101 ASSURANCE AGREEMENTS AND GSM-102 PAYMENT GUARANTEES COVERING CREDITS TO THE POLISH PEOPLE'S REPUBLIC (POLAND)

DEAR SIR:

PLEASE BE ADVISED THAT MARINE MIDLAND BANK, N.A. HEREBY ACCEPTS THE ABOVE REFERENCED OFFER OF THE CCC, AS SET FORTH IN THE TELEX OF THE CCC DATED JANUARY 29, 1982 AND AS EXTENDED THROUGH FEBRUARY 26, 1982 AND FURTHER EXTENDED THROUGH MARCH 26, 1982, TO REPURCHASE THE OUTSTANDING OBLIGATIONS OF THE PAYMENT GUARANTEES ISSUED BY THE CCC PURSUANT TO ITS GSM-102 EXPORT CREDIT GUARANTEE PROGRAM REGULATIONS COVERING COMMERCIAL CREDITS EXTENDED TO OBLIGORS OF THE POLISH PEOPLE'S REPUBLIC (''POLAND'').

VERY TRULY YOURS,

A KEES JORDAN, VICE PRESIDENT, MARINE MIDLAND BANK N.A.

r

o
TLMK WSH

To
TLMK WSH

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TREASURER COMMODITY CREDIT CORP
US DEPARTMENT OF AGRICULTURE
12TH & INDEPENDENCE AVE
WASHINGTON DC
BT

WITH REFERENCE TO YOUR TELEX OF JAN. 29 1982 CONCERNING YOUR OFFER TO REPURCHASE YOUR OBLIGATIONS UNDER GSM-102 COVERING COMMERCIAL CREDITS TO POLAND, WE HEREBY ACCEPT YOUR OFFER STOP
REGARDS,
MTF WINGATE, VICE PRESIDENT
BANK OF BOSTON INTL
NEW YORK
CORRPOS NYK/SD

NNNN
2104 EST
o
TLMK WSH

RE GSM 102 - CCEN TO POLAND

REPEATING OUR TELEX TO TREASURER OF CCC DATED JAN 29 1982

QUOTE:

TREASURER

COMMODITY CREDIT CORPORATION

U.S. DEPT OF AGRICULTURE

WASH, DC

FM NYK 01/29/82 09:33 EST KS .837.

WE ACKNOWLEDGE RECEIPT OF CCC.S TELEX DATED JAN. 28, 1982, CONTAINING AN OFFER TO REPURCHASE OUTSTANDING OBLIGATIONS UNDER GSM-102, COVERING COMMERCIAL CREDITS EXTENDED TO OBLIGORS OF POLAND.

WE HEREBY ACCEPT HIS OFFER AND SELECT OPTION P(A). PLEASE NOTE THE ITEMS CURRENTLY OUTSTANDING ARE AS FOLLOWS, ALL COVERING SEMI ANNUAL INTEREST DUE ON THE DATES SHOWN.

GSM ACCT NO.	DUE DATE	INTEREST DUE
102-117	JAN 7, 1982	DUES 91,681.51
102-116	JAN 8, 1982	DUES 164,215.38 Rec'd
102-119	JAN 11, 1982	168,271.65
102-920	JAN 22, 1982	228,481.55

CONTINENTAL GRAIN EXPORT CORPORATION

A. SLAFCIZKY/ASST V.P.

ASCS WSH

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NISROCK NYK

FROM NYKYU FEB-5

TO: TREASURER FEBRUARY 5,1982 TLX NO. 288

COMMODITY CREDIT CORPORATION

U.S.DEPARTMENT OF AGRICULTURE

P.O.BOX 2415

WASHINGTON D.C. 20013 (TELEX NO.89491)

RE: CCC PAYMENT GUARANTY NO. GSM-102-58

SUBJECT: CCC OFFER AS TO GSM-102 PAYMENT GUARANTEES COVERING CREDITS TO POLAND (THE ''OFFER'')

DEAR SIR:

THE UNDERSIGNED EXPORTER HEREBY ACCEPTS THE OFFER OF THE CCC DATED JANUARY 29,1982.

VERY TRULY YOURS

NISSHO IWAI AMERICAN CORPORATION

FOODSTUFFS DEPARTMENT

1211 AVENUE OF THE AMERICAS

NEW YORK, N.Y. 10036

TELEX NO. 127997 NIAC NYK

March 11, 1982

Mr. Rob A. Brammer
Treasurer
Commodity Credit Corporation
U.S. Department of Agriculture
P.O. Box 2415
Washington, D.C. 20013

Dear Mr. Brammer:

We herein notify you of our decision to accept your offer contained in your January 28, 1982 telex submitted to the banks by Alan T. Tracy. Further, it is our intention to elect Option B with regard to the obligations listed below:

Series	Principal Amount	Letter of Credit #	Maturity Date
4000	$ 1,300,627.13	926254	February 16, 1982
4001	$ 1,310,350.44	926350	February 23, 1982
4002	$ 993,426.00	926482	February 25, 1982
4003	$ 1,356,009.44	926351	February 18, 1982
4004	$ 626,798.33	926555	February 26, 1982
4010	$ 37,955.80	926556	February 17, 1982
4012	$ 39,476.62	926586	February 26, 1982
4009	$ 7,234.11	926633	March 3, 1982
Total Principal Outstanding:	$ 5,664,643.76		

Contained herein are the documents specified in 7 CFR 1487.8(B) (3) (1), (III) and (IV). In notifying you of our decision to select Option B on the above outstanding obligations, it is our understanding that you will reimburse Chemical Bank for the total principal amounts specified above and that Chemical Bank retains full right and title to the corresponding interest amounts.

This acceptance is without prejudice to our consideration of any further amendments to your offer.

Sincerely,

Paul McCarthy

March 23, 1982

Treasurer
Commodity Credit Corporation
U.S. Department of Agriculture
P.O. Box 2415
Washington, D.C. 20013

Re: Offer by Commodity Credit Corporation ("CCC") dated January 17, 1982, as subsequently extended ("the Offer") to Holders of GSM-101 Assurance Agreements and GSM-102 Payment Guaranties Covering Credits to Poland

Gentlemen:

The First National Bank of Chicago and its wholly-owned Edge corporation subsidiary, First Chicago International, hereby accept the referenced Offer in respect of the Obligations (as defined in the Offer) held by them. The Offer is accepted with the understanding that, if CCC should modify the Offer to provide for options in addition to those set forth in paragraph 2 of the Offer, the undersigned will be entitled to avail themselves of such additional options (in respect of amounts not already subject to election of another option on the date of such modification) on the same terms as any other holder of GSM-101 Assurance Agreements and GSM-102 Payment Guaranties covering credits to Poland.

Please acknowledge your receipt of this letter of acceptance by signing and returning to the undersigned the enclosed copy of same.

Very truly yours,

THE FIRST NATIONAL BANK OF CHICAGO

By: _____
Title: _____

FIRST CHICAGO INTERNATIONAL

By: _____
Title: _____

POLAND'S IMF MEMBERSHIP APPLICATION

Senator Kasten: What is the status of the application of Poland to join the International Monetary Fund? I understand that an IMF team was in Poland at the time martial law was imposed, but left the country on the first available transportation. Has this IMF team completed its report? What is the U.S. Government's position on the Polish application? If martial law continues, what can the United States do to prevent the martial law regime from using part of the $5 billion that the subcommittee and the Congress appropriated two years ago for the IMF?

Mr. Leland: The IMF is continuing technical discussions with the Polish authorities on Poland's application for membership. It is our understanding that the application for membership will not be ready for consideration by the IMF Executive Board for some time.

The United States determines its position regarding membership applications to the IMF on a case-by-case basis. The imposition of martial law in Poland has undoubtedly complicated negotiations on its membership in this institution. The United States and other IMF members will need to consider carefully the results of the negotiations and developments in Poland before reaching a decision on the issue. In making our determination we will have to reach a conclusion as to Poland's willingness and ability to fulfill the responsibilities and obligations of IMF membership.

At this stage, it would be premature to consider the issue of IMF financing for Poland. The technical discussions on membership have not been completed and the Executive Baord has not considered the application. Moreover, membership in the IMF does not mean that financing is provided automatically.

U.S. GOVERNMENT GUARANTEE PAYMENTS

Senator Kasten: What were the amounts of guarantees of private loans to Poland that were paid by the Federal Government, by agency during fiscal year 1981? What were the scheduled amounts of principal and interest on direct Federal loans that were due to U.S. Government agencies? How did this compare with the actual amounts received by the Treasury?

Mr. Leland: The Commodity Credit Corporation guarantees of private bank loans during the last three-quarters of 1981 totaled $159 million. This is the sum that was paid.

In 1981, Poland owed the CCC and the Export-Import Bank $241 million and $25 million respectively in direct credits. CCC rescheduled $217 million and the Export-Import Bank $22 million. Poland is $11 million in arrears to the CCC on the non-rescheduled portion and $1.4 million to the Export Import Bank.

POLAND'S 1982 DEBT SERVICE OBLIGATIONS TO THE U.S. GOVERNMENT

Senator Kasten: For fiscal year 1982, what has been the record to date on guaranteed and direct loans? What do you anticipate to be the cost of the Polish debt situation to the U.S. Government during the remainder of fiscal year 1982, in terms of both payments of

guaranteed loans and foregone receipts of principal and interest on direct loans.

Mr. Leland: In 1982, Poland's debt service obligations to the Export-Import Bank will total $60 million. About $24 million of this sum is in arrears at present. Poland will also owe the Commodity Credit Corporation $295 million in principal and interest for direct credits in 1982. They are $69 million in arrears on these payments as of March 31, 1982. CCC guarantees of private bank loans falling due in 1982 total $306 million.

BUDGET IMPACT

Senator Kasten: Are these fiscal year 1982 amounts fully reflected in the 1983 estimates published in the new budget we received over the weekend? Do the fiscal year 1983 budget estimates reflect payments from Poland? (If so), how much is expected? Has the Government made any plans to write off these claims or place them in a special category in the budget schedules?

Mr. Leland: The 1982 and 1983 budget estimates do not assume additional rescheduling. The U.S. Government has not made any plans to write off these claims or place them in a special category in the budget schedules. However, the current CCC budget estimates contain a $400 million line item for general contingencies (including nonpayments of loans) in FY 1982 and again in FY 1983.

The Export-Import Bank has retained earnings over time against which any future write-off would be made.

Questions Submitted by Senator Inouye

POLISH DEBT TO THE UNITED STATES

Senator Inouye: What is the total amount Poland owes to Western banks and government institutions? Of that amount, how much is owed to U.S. banks and how much to the U.S. Government? What is the maturity structure of this debt? How much of the Polish debt to U.S. private creditors is guaranteed by the U.S. Government? Have the funds which may be required to meet these guarantees been appropriated, or will future appropriations be required?

Mr. Leland: Poland has an external hard currency debt of approximately $26 billion; government and government guaranteed debt is some $17 billion; private unguaranteed debt is some $9 billion. Polish debt to the United States totals $3.1 billion. The breakdown of this figure is:

Non-guaranteed loans from private creditors (primarily commercial banks)	$1.3 billion
Direct credits and guarantees by the Commodity Credit Corporation	$1.6 billion
Export-Import Bank Loan	$ .2 billion
AID Loan	$ .006 billion
Total	$3.106 billion

89-938 O - 83 - 9

Nearly all the debt to the U.S. Government will fall due by 1984. CCC is funded from a revolving fund with a $20 billion ceiling for total outstanding borrowings. Appropriations are usually required only for past net realized losses. Since rescheduled loans are not considered losses, appropriations for these sums will not be required in the near future.

POLAND'S FIVE LARGEST OFFICIAL CREDITORS

Senator Inouye: Which country holds the largest amount of Polish debt? Please provide a table for the record indicating the amounts owed to the five principal creditors.

Mr. Leland: Poland's five largest creditors are:

Federal Republic of Germany	$4.4 billion
United States	$3.1 billion
France	$2.8 billion
Austria	$1.9 billion
United Kingdom	$1.7 billion

The above amounts are estimated, and include both official/officially guaranteed claims and private claims.

POLISH DEBT ARREARAGES

Senator Inouye: How much principal and interest on Polish debt is in arrears? To whom is it owed? How much will fall due in 1982?

Mr. Leland: Poland is apparently current on all of its 1981 interest obligations to western banks and, with several exceptions, on its non-rescheduled debt obligations to western governments. In 1982, Poland's debt service to western creditors will total about $10.4 billion. Approximately $4.7 billion of this amount is owed to western governments. Poland is making some payments to private creditors on its 1982 obligations but apparently is not making payments to western governments.

As far as the U.S. Government is concerned, Poland's debt service obligations to the Export-Import Bank in 1982 will total $60 million. Approximately $24 million of this total is in arrears at present. In addition, Poland is also $1.4 million in arrears on 1981 non-rescheduled debt to the Export-Import Bank and $1.3 million of interest due on the 1981 rescheduled debt.

Poland will also owe the Commodity Credit Corporation (CCC) $257 million in principal and $38 million in interest for direct credits in 1982. CCC guarantees of private bank loans falling due in 1982 include $267 million of principal and $39 million of interest.

Poland's arrearages on 1982 payments to CCC total $69 million as of March 31, 1982. They are also $45 million in arrears on 1981 obligations.

U.S. DEBT RESCHEDULING POLICY TOWARDS POLAND

Senator Inouye: What is the current U.S. position with regard to rescheduling of official debt in 1982? Do the Western creditor nations have a common, unified position on rescheduling?

Mr. Leland: In January 1982, we and our Allies agreed to suspend consideration of talks on rescheduling Poland's 1982 debt obligations. This position still stands. (Please see following question and answer for specific conditions.)

POLISH DEBT SERVICING CAPABILITIES

Senator Inouye: Can the people of Poland meet their debt-servicing costs without additional external credits? If the West does not provide additional loans, will it be necessary for the Soviet Union to provide hard currency loans to Poland? What is the relationship between the creditworthiness of Poland and that of the Soviet Union?

Mr. Leland: Even before martial law, there was no question that Poland would require rescheduling of 1982 debts and new capital inflows from the West to help fill its financial gap. In the post-martial law period, it is clear that Poland's situation will be even more difficult. We are not putting any new money into Poland, and other official creditors have agreed to follow this policy. In addition, we and other offical creditors have agreed not to enter into negotiations on 1982 debt until: (1) martial law is relaxed; (2) the detainees are released; and (3) the regime begins negotiating with Solidarity and the Church.

This policy will force the Poles to squeeze their domestic economy even more than they had anticipated and/or place the burden of providing resources squarely on the shoulders of the Soviet regime. We know that this is happening to a large extent at the present time, and expect that the burden on the Soviets will increase concomitantly with Poland's needs for resources.

In the eyes of Western lenders, the creditworthiness relationship between Poland and the USSR is asymmetrical. The Soviets could enhance Poland's creditworthiness by formally acknowledging some responsibility for Poland's debts. Poland's financial difficulties, by themselves, will not have a significant impact on Western views of Soviet creditworthiness, although they have resulted in increased attention to the creditworthiness of the Soviets and the other countries in Eastern Europe.

PROSPECTIVE LENDING TO POLAND

Senator Inouye: Do you think commercial banks will provide new loans to Poland under present conditions? What changes would have to occur? Under what circumstances would the U.S. consider extending new loans or guarantees on new private credits? Do other Western governments have similar requirements?

Mr. Leland: Commercial banks have ceased new lending to Poland and are not likely to resume lending under present conditions. We cannot speak for the banks in terms of their lending attitudes. This they will have to determine for themselves. Although the U.S. has not specified exactly under what circumstances it would consider

extending new loans or guarantees on new private credits, such consideration would clearly not be given until at a minimum, (1) martial law was repealed; (2) the political prisoners released; and (3) the regime entered into meaningful discussions with Solidarity and the Church. Other Western governments have not explicitly indicated the conditions under which they will resume lending to Poland.

IMPACT OF A FORMAL POLISH DEFAULT

Senator Inouye: If the United States were to formally declare Poland in default, what impact could that declaration have on the U.S. financial system? How would it affect our Allies, especially Germany?

Mr. Leland: We don't believe that the solvency of any U.S bank would be threatened by a Polish default. The bulk of the banks involved in lending to Poland have kept their exposure below five percent of their capital. To be sure, a loss of this magnitude would be unpleasant, but, even if a bank did not already have provisions against losses on its loans to Poland, such a loss would in most cases be only a fraction of its annual profits in other business.

The impact on the banks of some other countries would be greater because of their relatively heavier exposure in Poland. However, while comprehensive data are not available, we believe that almost all non-U.S. banks would be able to absorb a loss on Polish loans without any significant impairment of their capitalization. Consequently, we would not envision an unmanageable impact on the international banking system as a whole.

IMPORTANCE OF WESTERN CREDITS

Senator Inouye: How important are Western credits to the economies of Eastern Europe and the Soviet Union?

Mr. Hormats: Western credits, both private and officially-backed have financed an important share of Soviet and Eastern European imports from the West. For example, new Western Government medium and long term credits and guarantees will cover more than 10 percent of Soviet imports in 1982. The share covered by private bank credits is expected to be about 8 percent. The Soviets could maintain close to their current import level without these credits, but only by dipping heavily into their gold reserves.

Eastern European countries, with the exception of Bulgaria and Czechoslovakia, are much more dependent than the Soviet Union on Western credits. Official and private credits are likely to finance over 70 percent of Eastern European imports in 1982. The recent decline in new bank lending to these countries has already begun to affect their ability to service their debt to the West.

Senator Inouye: How important to the United States is trade with Eastern Europe and the Soviet Union?

Mr. Hormats: In strictly economic terms, trade is rather small. However, trade and economic relations are an important component of U.S. relations with individual countries of Eastern

Europe. Only 1.8 percent of total U.S. exports goes to the USSR and Eastern Europe (0.9 percent to the USSR and 0.9 percent to Eastern Europe), mostly in the form of agricultural commodities. In turn, 0.6 percent of U.S. imports come from CEMA countries, including several strategic minerals from the USSR. The U.S. enjoyed a $2 billion trade surplus with the CEMA countries in 1981. While the overall magnitude of U.S. trade with the CEMA is small, Eastern markets are important to certain industries and sectors, particularly our agricultural sector.

SOVIET UNION AND POLISH DEBT

Senator Inouye: What options are available to the United States to press the Soviet Union to assume responsibility for financing Poland's debt?

Mr. Hormats: The Soviet Union did not guarantee the Polish debt and has no legal responsibility to pay it. The U.S. has no leverage with the Soviet Union in this matter.

Senator Inouye: Why would it be in the Soviet Union's interest to finance Poland's debt?

Mr. Hormats: It is not clear that the Soviets would see it in their interest to finance Poland's debt. The current Polish financial crisis has already spilled over onto other East European neighbors who are encountering increasing difficulties in rolling over short-term commercial debt and in contracting new medium/long term loans. These countries are thus beginning to suffer difficulties in maintaining import levels and in servicing their debt. Poland's bankruptcy demolished the theory that the Eastern European countries operated under a Soviet financial "umbrella". Thus, a Soviet willingness to pay the Polish debt might help restore the credibility of the "umbrella theory", reduce the anxiety among Western lenders and allow for continued Western credits to other East European countries. However, the immediate cost to the USSR of bailing out Poland would be enormous -- about $11 billion in 1982 alone. Thus, the Soviets may prefer to dole out measured amounts of assistance to other CEMA countries over time, rather than to shoulder the heavy Polish debt burden now.

Senator Inouye: Does the Soviet Union have the capacity to do so?

Mr. Hormats: The Soviet Union provided Poland an estimated $4 billion in economic assistance in 1981 -- approximately $1 billion in hard currency assistance and the balance in the form of goods. It is highly unlikely, however, that the Soviet Union could fill Poland's estimated $11 billion financing gap in 1982 even if it wished to do so. There are increasing indications that the Soviet Union is encountering an increasing hard currency shortage of its own. It has drawn heavily on hard currency balances in Western banks, increased gold sales, and diverted oil exports from Eastern Europe to Western markets to increase hard currency export earnings. Moreover, Soviet medium/long-term borrowing is likely to become more expensive. Consequently, the Soviets will have their hands full financing their own essential imports and servicing their debt over the next several years.

Senator Inouye: What would be the likely consequences to the Soviet Union and to Poland if the Soviet Union assumed responsibility for Poland's debt.

Mr. Hormats: In addition to the serious financial strain it would represent for the Soviet Union, it would also set a precedent with regard to Soviet obligations vis-a-vis its other East European allies. In short, the Soviets would be validating the "umbrella theory" a step they have studiously avoided. The Soviet Union is not, nor is it likely to become any time in the near future, able or willing to assume debt obligations of all its allies.

Senator Inouye: Do you have any factual basis to support the contention that the Soviet Union would find it necessary to reduce its military expenditures in order to finance Poland's debt?

Mr. Hormats: There is no factual evidence to support such a contention. The Soviets attach high priority to their military program and have devoted a steady share of resources (13 to 15 percent of GNP) to military spending over the past decade. Accordingly, they would make every effort to avoid a cutback on military expenditures to service Poland's debt, let alone maintain Poland's standard of living. Moreover, even if the Soviets felt forced to cover Poland's debt, the resources would come out of the consumer goods sector or reserves, not the military.

Senator Inouye: Is there not a strong possibility of intensified Soviet repression in Eastern Europe as a result of the Polish debt crisis?

Mr. Hormats: To the extent that the Polish debt crisis also intensifies the economic problems of other Eastern European countries, it may also stimulate further political unrest. Eastern European governments -- supported by the Soviet Union -- would likely respond to such unrest by strengthening their repressive measures.

Senator Inouye: Is there a possibility that the Soviet Union will attempt to extract wealth from other Eastern European countries in order to pay Poland's debt to the West?

Mr. Hormats: Many of Eastern European economies are suffering from slow economic growth and the consequences of poor economic management. They are incapable of providing significant assistance to Poland without undergoing a decline in their own living standards, a development which would increase the potential for unrest. Therefore, we doubt that the Soviet Union will attempt to extract resources from other CEMA countries to support Poland, particularly since this would amount to a transfer of wealth from CEMA countries to Western banks or governments.

Senator Inouye: Would that not itensify Soviet repression throughout Eastern Europe?

Mr. Hormats: To the extent that the other Eastern European countries were to assist Poland with financial and commodity aid, they would be diverting their scarce resources and lowering their people's standard of living. Should the lowered living standards result in increased unrest, local authorities, presumably

with the blessing and support of the Soviet Union, might resort to increase of repression.

Senator Inouye: Do you have any evidence which indicates that the Soviet Union is compelling Eastern European governments to provide aid to Poland?

Mr. Hormats: There is some evidence that the Soviet Union has pressured Eastern European allies to aid Poland, but, given the economic difficulties those countries also face, there has been little significant aid to date. We do not expect Soviet pressure to intensify.

REACTION OF PEOPLES OF EASTERN EUROPE

Senator Inouye: Have you considered how the people of Eastern Europe will respond to the West's demands for payment?

Mr. Hormats: It appears clear from our experience in Poland, that Western creditors seeking repayment on loans contracted by Poland have not thus far been held responsible for the country's economic problems -- Polish and Soviet propaganda notwithstanding. The Poles realize that bad economic policies, mismanagement and corruption associated with an ossified bureaucracy and Communist Party have produced the current economic crisis. Nevertheless, as Poland's economic crisis deepens, it will be increasingly difficult to avoid the perception, both in Poland and in Europe, that our sanctions are hurting the Polish people more than the Polish Government. For this reason, continued Western humanitarian assistance to the people of Poland is extremely important. This assistance is evidence of the West's continued support for the Polish people.

Senator Inouye: Will the people of Poland in their despair come to think of the United States as a fortress of ruthless capitalism and not as the home of freedom and compassion?

Mr. Hormats: After the declaration of martial law, U.S. and allied sanctions were directed against the Polish Covernment, which was systematically violating the Polish people's human rights, and not against the Poles themselves. To make this point very clear, the allies agreed to continue humanitarian assistance to Poland and to channel this assistance through voluntary organizations like Catholic Relief Service and CARE rather than through the GOP. The Polish people and some Solidarity members who are in the West appear to understand our policy. Nevertheless, there is a danger that public perceptions in Poland could shift if the present situation continues for a long time. It is thus very important for us to maintain our positive stance on humanitarian assistance as a symbol that we have not abandoned the Polish people to their oppressors.

Senator Inouye: Can the Soviet Union exploit the Polish debt crisis and score a propaganda victory?

Mr. Hormats: The Polish crisis represents the failure of the Soviet-imposed Communist system in Eastern Europe. The Soviets are trying to hide that failure by dividing the Western alliance over sanctions. We and our allies are attempting to ensure that there be a united, as well as meaningful, Western set of sanctions and that there be no chance for the Soviets to use disagreement

over sanctions to drive a wedge between the U.S. and our NATO allies. In short, to allow this would be playing into Soviet hands. To be effective, sanctions must be broadly applied and all parties must adhere to them. At the same time, there must be a prospect of U.S. and Western assistance if the Polish Government complies with our political conditions. This would make clear to the Polish people and the public that we have no intention of abandoning the Polish people to their fate.

U.S. ALLIES

Senator Inouye: If the United States declared Poland in default, what effect will that have on our relationships with our allies?

Mr. Hormats: The allies met in January and agreed not to invoke the "special circumstances clause" of the official rescheduling agreement, despite the declaration of martial law and the fact that the Poles remained in arrears on their debt service payments to the West. This would have had the effect of declaring Poland in default, a move our European allies wished to avoid. The allies also decided to defer any consideration of a 1982 debt rescheduling. Were the USG unilaterally to declare Poland in default now, especially without prior consultation, the Europeans probably would not follow suit and a severe split in the NATO alliance could open.

Senator Inouye: Can the Soviet Union exploit the Polish debt crisis by dividing the West?

Mr. Hormats: We and our allies are united in the view that the West should keep pressure on Poland to pay what it owes. Continued close allied consultations on Polish debt and sanctions will help prevent divisions.

Senator Inouye: Can you summarize the views of our allies on the Polish debt crisis?

Mr. Hormats: Our allies believe that we can maximize our chances of repayment and best keep up sustained pressure on the Polish Government -- and indirectly on the Soviet Government -- by insisting that Poland pay its debts in a timely manner. They share the U.S. view that a declaration of default, while not legally absolving the Polish Government of its debt obligations, could give it a political excuse to stop repayment of debt.

Senator Inouye: In strict economic terms, who has the most at risk, the U.S. or its allies?

Mr. Hormats: While Polish debt to the United States is not negligible, the bulk of the debt is owed to Western Europe. In addition, the Europeans depend more heavily than the U.S. on trade with Eastern Europe or the USSR. Thus, any disruption of East-West trade that accompanied default would hit the Europeans harder than it would the U.S.

SUBCOMMITTEE RECESS

Senator KASTEN. The subcommittee stands in recess.

Senator MOYNIHAN. Thank you, Mr. Chairman.

[Whereupon, at 12:20 p.m., Tuesday, February 9, the subcommittee was recessed, to reconvene at 10 a.m., March 2.]

POLISH DEBT CRISIS

TUESDAY, MARCH 2, 1982

U.S. SENATE,
SUBCOMMITTEE ON FOREIGN OPERATIONS,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10 a.m., in room 1318, Everett McKinley Dirksen Senate Office Building, Hon. Robert W. Kasten, Jr. (chairman) presiding.

Present: Senator Kasten.

NONDEPARTMENTAL WITNESSES

OPENING STATEMENT OF SENATOR KASTEN

Senator KASTEN. The subcommittee will come to order.

This morning we will continue our hearings which began on February 9, 1981, when we received testimony from the Departments of Defense, State, Treasury, and Agriculture on the Polish debt situation and our policy toward Poland, Eastern bloc countries and the Soviet Union vis-a-vis financial credits.

Today we are fortunate to have three distinguished nongovernmental witnesses, who will present testimony on the situation in Poland as they see it, both with respect to the debt situation, but more generally on the current situation in that troubled country.

INTRODUCTION OF WITNESSES

These witnesses are, first of all, Mr. Jan Nowak, who is a consultant to the National Security Council and a national director of the Polish American Congress. Mr. Nowak has had a distinguished career. He was the director of the Polish Division of Radio Free Europe, editor of the Polish Service of the BBC, member of the Polish resistance movement during World War II, and the emissary of the commander-in-chief of the Polish Home Army to the allies, among other things. Mr. Nowak is recognized as one of the foremost experts on Polish affairs in the United States.

The Hon. Zdzislaw Rurarz, the former Polish Ambassador to Japan, who courageously defied the current military government by seeking political asylum in the United States; and Prof. Wojciech Karpinski, a visiting professor at Yale University, who was an active member of Solidarity as a writer, lecturer, and advisor.

We are especially honored to have these gentlemen with us today, and I am confident they will add greatly to our knowledge of the situation in Poland.

U.S. FIRMER RESPONSE TO POLISH CRISIS

Since this subcommittee last held hearings on the Polish debt situation, a number of events have occurred concerning the Polish crisis; the most important being the development of a general consensus that the United States must take a firmer stand in its foreign policy toward the military dictatorship in Poland, the Eastern bloc and, most especially, the Soviet Union.

DEBT DEFAULT DECLARATIONS

More specifically, with respect to the debt situation, it is interesting to note that President Reagan personally intervened in similar financial dealings concerning Romania by refusing to provide additional credits and demand that the country pay its arrearages. I have no doubt that this action by the President was influenced, in part, by our efforts, both through congressional hearings and action on the floor of the Senate.

Since we highlighted this issue 3 weeks ago, a number of congressional bodies have undertaken hearings on this question. A number of my colleagues who originally did not support our efforts on the floor of the Senate have now indicated that they would be willing to do so in a similar effort.

What I am suggesting is that we are making progress. I intend to continue my efforts in this area, and, as an additional step, will introduce legislation this afternoon which seeks to require default declarations, not only with respect to Poland, but with respect to any country which refuses to pay its debts.

Our first witness is Mr. Nowak. Mr. Nowak, if you would come forward and begin your testimony.

Polish American Congress

STATEMENT OF JAN NOWAK, CONSULTANT TO THE NATIONAL SECURITY COUNCIL AND NATIONAL DIRECTOR OF THE POLISH AMERICAN CONGRESS

QUESTIONS ON POLISH SITUATION

Mr. Nowak. Mr. Chairman, I appreciate very much this opportunity of testifying before the subcommittee on Poland. I propose to address myself to the following questions: What has been achieved by Moscow and by the junta, at what expense, and what is the situation as of today?

Two, what is the strategy, tactics, and objectives of the underground Solidarity?

Three, what are the possible options in the future for the Soviet policy, and how U.S. policy may influence the further course of events?

And finally that would bring me to the basic question: What should be done with the Polish debts?

I should skip historical analysis. I think it is established by sufficient evidence that the decision of the military takeover was taken in Febru-

ary, at the time when Jaruzelski became the Prime Minister in addition to being Minister of Defense.

EVENTS LEADING UP TO MARTIAL LAW

Preparations started in March. The military council of six generals, with Jaruzelski as its head, was formed secretly in September and the operation was scheduled, provisionally, for December 20 and then, in the last few weeks, moved to December 13.

The only difference between so-called moderates and hardliners concerns tactics and timing. The settlements in Gdansk were not signed in good faith. They were necessary in order to bring the strikes to an end and to gain time. Now the military crackdown was carried with the impressive effectiveness and speed and the initial objective was achieved, which is the suppressing, the smashing of the gigantic organization at work of Solidarity.

LOSSES RESULTING FROM MARTIAL LAW

The losses dealt by the military crackdown to the Polish economy are staggering. The workers, deprived of their leadership, responded by spontaneous strikes in 194 major plants, mines, dockyards, steel mills, and so on. It took 25 days until a normal workday was restored throughout the country.

In spite of the fact that there were no strikes in January, the production in January declined by 17.5 percent in comparison with December, which was the month of strikes. This may be partly explained by the workers' slowdown, but mainly by lack of raw materials, spare parts, power, and all the materials which were previously imported from the West, either for hard currency or for credits.

DISRUPTION OF COMMUNICATIONS

Regardless of the strikes, disruption by shutting off of telephones and telexes and postal services, ban on travel by private cars and ban on travel disrupted completely any possibility of communication and coordination between industrial establishments which particularly, under the system of overcentralized economy, must be particularly damaging.

In addition to all of this, martial law paralyzed the hydrological services. The result, the flood alert, was not sounded on time. No preventive measures were taken and the flood in the Upper Vistula of unprecedented size took place in February.

AGRICULTURAL SHORTAGES

At this moment, one factory or another either has to be shut up or at least take slower pace because of the lack of raw materials and spare parts. Agriculture is probably the most critical sector of the front. Poland will need, according to official figures, 2.5 million tons of grain in the first 6 months of this year, which has to be either imported from the West or provided by the countries of the COMECON.

There is, according to the official statements of Deputy Prime Minister Roman Malinowski, a critical shortage of seeds and seed potatoes. The production of fertilizers was brought almost to nil, again because of the lack of chemicals imported from the West.

According, again, to official data, about 50,000 tractors will be idled because of the lack of batteries, spare parts, and gas. The authorities expected that the procurement will give, after the last harvest, 3,600,000 tons of grain. Instead they got only half of it.

It is possible after the sowing season they may have to reintroduce compulsory delivery, which would mean, in effect, a war with peasants. In the long run, this definitely would considerably deteriorate the situation in agriculture. So food will probably become the main destabilizing factor, if not in the next few months then within a year.

HARD CURRENCY REQUIREMENTS

According, again, to the Minister of Treasury Marion Krzak, Poland will need $6 billion in hard currency to keep the economy afloat. I am not referring here to $10 million, which would be needed to repay the interest and capital in this year—$10 million, one-third of the Polish, or even more than one-third of the Polish debt—are due this year.

Well, there is no question that the military crackdown dealt a devastating blow to the Polish economy, which was already in a most critical condition before December 13. There are no indications so far of any positive and critical program. I couldn't find it in any public pronouncement of either General Jaruzelski or any of his spokesmen. They are devoid of any proposals, any propositions, and any innovation, and I believe that they themselves are at a loss as to how to handle monumental and increasing economic and social problems.

POLITICAL REPERCUSSIONS OF CRACKDOWN

Now in political terms, the main objective was to restore fear, which had really disappeared in the years between 1976 and 1981 or 1980, to intimidate people by massive application of reprisals, to intimidate people into submission and better work.

This objective has not been achieved so far. The crackdown and terror did create an abyss of suspicions, mutual fear, even hatred between the population and the regime, which has no other base at this moment than the police—the officers cadres are part of it—and the state party bureaucracy.

I cannot think of any government who is so isolated from its own people as the Jaruzelski junta. There are many displays of opposition. Intellectuals and workers are returning their party cards in protest. There have been many petitions and protests signed by outstanding people, outstanding intellectuals, who signed themselves with their name, their addresses. There were such petitions in Crakow, in Warsaw, and in other cities.

One of them has been signed first by 124 people who are, all of them, well-known names—scholars, artists, writers, and so on. Now the number of the signatures under this one petition reached 400.

ACTIVITIES OF SOLIDARITY FOLLOWING MARTIAL LAW

Solidarity itself, now about 200 leaders and activists, evaded arrest and went underground. By all kinds of leaflets, information bulletins, slogans painted after curfew and under cover of darkness, Solidarity made it known to Poland, to Polish people, and to us here that it still exists, and it is very much alive and active.

Now I believe they have two basic objectives. One is to follow the message of Lech Walesa. Let's not allow people to break down—the morale of people to break down. The second objective is to warn against any kind of violence and terrorism. Almost every group of underground Solidarity is on record as warning against violent confrontation with the authorities.

Instead, they do advocate the forming of spontaneous groups to help the victims of reprisals and to prevent polarization of the society; and, second, to offer as much nonviolent, passive resistance as possible, to slow down the work, and to use the so-called Italian strike.

I am not in a position to assess how effective this is. It seems to me the regime has had success only in the coal industry, whereby draconian measures, the 10 hours' work was introduced and the miners are working under such a system of intimidation and terror that production, I believe, has been increased only in this one sector.

EXPECTATIONS OF SOLIDARITY

Now what are the expectations of Solidarity, and what is the strategic goal? In the first place, in their publications they offer strong support to the sanctions initiated by the United States, and they themselves used sanctions against the government by calling for the passive resistance. They expect, of course, the support for Reagan's moves were coupled—and I have the text here—with the concern that they may finish like in Afghanistan. In other words, they may not last long or may not be effective.

However, one has to say that the introduction of sanctions at the beginning of January, whatever their economic effectiveness, was a tremendous morale boost to the Solidarity and to people, letting them know that the battle is not over.

ACTIONS BY MOSCOW

Well, they do expect that internal resistance, compounded by economic sanctions from the West, may compel Moscow—and I repeat, Moscow—to allow the regime in Poland either to return to a dialog with Solidarity or at least to make unilateral concessions and unilateral efforts to restore work incentives and to introduce some kind of accommodation with the Polish people.

Now do they have a chance? Well, we have first to say that decisions concerning the Polish future and the kind of model that will emerge from the present state will be decided not in Warsaw but in Moscow. Moscow, of course, will be influenced by both dogmatic considerations and pragmatic considerations of the interests of the great power.

I think that as long as the entire Polish military leadership is involved in the internal front and in running the country, the Warsaw Pact alliance has to be and remain defensive allies. Poland represents 29 percent of the manpower of the entire Warsaw Pact, and it is assigned important strategic tasks in case of any attack on Western Europe.

Therefore, as long as the present state of affairs exists, the pact essentially can be only a defensive pact. Therefore, the Soviet Union has a vital interest to bring the situation back to normal. How and when it can be achieved is the main question.

SOVIET OPTIONS IN FACE OF COLLAPSE OF POLISH ECONOMY

Now the Soviet Union will face, within 1 year, a total collapse of the Polish economy, and in face of it, it has three basic options. The first is to bail out the Polish economy from its own resources and that of other countries of the COMECON. I think they may partly compensate for losses of imports from the West. They cannot possibly afford to replace the imports from the West by supply of their own hard currency, raw materials, gas, and so on.

The second option is to consider the Polish economy as a total loss and treat Poland as a military corridor. Now this would mean that they would have to support the army, the establishment, the party bureaucracy, police, and probably some key establishments. That would mean, in my view, in the long run a hunger holocaust in the heart of Europe, within 1 year, probably.

Senator KASTEN. Did you say a hunger holocaust?

Mr. NOWAK. Hunger holocaust, with uncontrollable riots and corresponding escalation of bloody terror.

In the early 1920's, we remember that 5 million people died in the Soviet Union in the Great Famine in the Ukraine, South Urals, and South Volga. I don't believe that this kind of scenario can be repeated in the present international context. I believe that it would have unpredictable consequences to the Soviet Union and to the entire world, and I don't believe this gloomy scenario is realistic.

The third option is to allow such reversal of the policy in Poland which could bring back the flow of credits and economic assistance from the West.

All three options are bad from the Soviet point of view, and I believe that they will try to restore the credits and assistance without having to pay the price by the game of deception, which may mean either appearances of liberalization without liberalization, or even a major deception game which would present Jaruzelski as being in danger of Soviet attack.

SOVIET MANEUVERS DUE

There were press reports that the Soviets are preparing for major maneuvers of the Warsaw Pact armies sometime in March or April around the Soviet-Polish borders and inside Poland. Now what for? I don't believe for 1 minute that as long as Jaruzelski is willing to follow the orders from Moscow that there is any need of the Soviet invasion.

The Soviet invasion is highly counterproductive from that point of view. They achieved their initial purpose at the minimum cost without invasion, using invasion by proxy. I think the only objective of such a demonstration of power could be indeed a deception game, which would convince the West that Jaruzelski is a lesser evil and the alternative could be Soviet invasion and, therefore, he should be supported.

If this deception would not work, then I believe the Soviets would have probably, sooner or later, to reconsider their present policy. That brings me to the problem of U.S. policy and the problem of credits.

We should, first of all, realize what is at stake. Eastern Europe was shaken by revolutionary tremors seven times since Stalin's death—in Poland, in Hungary in 1956, in Czechoslovakia in 1968, in Poland again in 1970, 1976, and 1980. If the Soviets should come to a conclusion that massive application of terror brought them full success, they may feel encouraged to prevent this kind of upheaval once and for all and to reintroduce the same kind of monolithic structure on the entire Eastern Europe that existed under Stalin—a structure that would be centrally guided from Moscow.

In the long run, this kind of monolithic structure would become extremely dangerous to the security of the United States and Western Europe, particularly at a time when cohesion of the Western alliance is getting loose and may lead, indeed, to disintegration of the alliance.

I believe that this kind of reimposition of the monolithic structure would considerably influence the military balance of power.

U.S. AND ALLIES RESPONSE TO POLISH CRISIS

The response of the United States and allies so far was largely symbolic. In my view, there are two schools of thought within the administration, one which believes that the NATO Alliance is the most important thing, the unity of the Alliance. Unfortunately, it happens very often in politics that what is the means becomes the purpose in itself. NATO serves as a means to assure the security and peace. Unfortunately, we may see with concern that on many occasions the NATO Alliance did prevent the United States from taking necessary steps to defend its own security and of Europe itself.

This is indeed the case in Poland, where in order to preserve the unity of the NATO Alliance, there is almost complete inactivity, which may serve a very dangerous signal of weakness and disunity. Indeed, the barking is so strong and the bite is so painless that I am afraid it may serve as encouragement to the Soviet Union to think that any international crisis is the best way to split the Alliance.

The second school of thought believes that the United States should take a lead, should take steps unilaterally and then exert maximum pressure on others to follow. Because of the conflicts of these two schools of thought, more than 3 weeks since the crackdown, the United States did nothing except make verbal announcements. Finally, President Reagan did announce sanctions and made a statement that if the situation in Poland were to continue, and I repeat, would continue, not deteriorate, there would be an escalation of sanctions. That has not happened so far.

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GRAIN EMBARGO

I believe there are three means of leverage we have. The first is embargo on grain. This was skipped. If there was any element of doubt in the Soviet mind that the embargo may be introduced, the recent statement by Secretary Haig at the meeting of AFL-CIO put this kind of fear at rest.

TRADE AND TECHNOLOGY EMBARGO

The second is embargo on trade and technology, and above all, the gas pipeline. Now, we know now that our allies would not allow us to do anything to stop the gas pipeline deal, and that even the U.S. modest efforts to deny some essential components, even this measure may be diluted by enterprises affiliated to America—such enterprises as General Electric. I think one of the purposes of the French minister's visit here is to persuade the United States not to go any further in trying to delay the deal.

CREDIT LEVERAGE

The last remaining leverage is the problem of credits. This is the only one that is still left, and it can be very effective. Now, should we declare Poland in default? In my view, it has to be done in two stages. This is the pistol with only one round of ammunition, and it has to be used within the framework of some kind of strategic plan. We cannot just drop this bomb and do nothing later. It would be highly, in my opinion, counterproductive.

In the first stage, we should extract from our allies a collective declaration that of all major state creditors, that default of one communist state would be automatically followed by a total credit embargo on the future credits.

Senator KASTEN. To that one communist state or to all communist states?

Mr. NOWAK. All communist states. It is very important, sir. The Soviet Union would survive economic isolation from the West, but satellites would not. The total embargo to all countries of the Soviet bloc would face the Soviet Union with an extremely difficult situation. They would have to bail out not just Poland, but the entire Eastern Europe, or the situation in Poland would spread to Czechoslovakia, to Romania in the first place, and to other countries of Eastern Europe, but the Soviet Union itself can survive economic isolation from the West, with difficulty, but it can.

POLISH DEFAULT

So, the loans to Poland were given on the assumption that there is a Soviet umbrella. Now we know that every spokesman of Soviet authority says that the Polish debts are the concern of Poland. Even if they do help Poland to repay a trickle of what they owe, this is done only to avoid default, and let's differentiate between old credits in default and new credits. The default in itself would simply take them off the hook, nothing more. They would have to pay nothing. But they are concerned

about defaults for one reason only. That would put a halt to a flow of any further credits in the future, and this is the basic thing.

You have to keep in mind that default is a leverage not only on the Soviet Union, it is the main leverage on our allies who do not want to declare Poland in default and who would pay a very high price, much higher than the United States. Should our allies refuse such declaration, which would make it a collective responsibility of the COMECON to bail out Poland, then we should go ahead with the default instantly and do it ourselves.

In the second stage, any rescheduling should be made conditional on lifting of martial law and introducing such measures which would make repayment of debt possible or at least more likely. I believe that the stakes are so high that it is not enough to threaten with negative measures. One should offer also some kind of constructive measures. What concerns me most is not that the United States pay the $71 million and at the same time to avoid default. What concerns me is the lack of any plan of what to do next. There is no strategic plan of what should be done in the future.

I believe one should also spell out some kind of incentives to the Soviet Union which would prevent setting the clock back to the early 1970's. In other words, we should spell out a program of assistance to Poland. If there is a negotiated settlement between the authorities and Solidarity, I think that everything possible should be done to avoid the possible scenario which would be, as I say, reintroduction of a Stalinist system of reign which would be encouraged by the success of police terror in Poland.

We should avoid one thing, under the impact of what happened in Poland, police elements in the Soviet Union and military elements in the Soviet Union, that they should get an upper hand at the moment, when the Soviet Union is on the verge of the change of power at the top.

Thank you very much.

TANK CLAUSE

Senator KASTEN. Mr. Nowak, I would like to thank you and congratulate you on your statement. The difficulty we have is that we have negotiated with our allies part of the way. In April we had a meeting with our allies, and said that if certain conditions occurred in Poland, that we, as an alliance, would force this debt into default. We came to that agreement—it is the so-called tank clause. Unfortunately, there is at least some argument as to whether or not the present repressive situation in Poland has, in fact, triggered that so-called tank clause.

In my opinion, there is absolutely no question that these are Soviet proxies who have come in. The tank clause has been triggered, and our allies should expect us to declare this debt in default; and our allies should join with us, according to the agreement made last April. It should be no surprise to the banks, nor to this administration. We should not have the confusion between different groups in our own administration, as we argue back and forth on whether or not the Alliance is more important than the Polish people.

The fact is, the Polish people are right now more important than the mere feelings of some of our NATO allies, and we could, we should be able to have both. It is not a question of one or the other, but the difficulty is that we did come to that agreement which you described as step No. 1. Now we have shown an unwillingness to abide by the April agreement with our allies, and that is the frustrating part of this, and it is the difficult part of it.

SOVIET GAS PIPELINE

I also am more optimistic, frankly, than you are. I know this argument is going on right now within this administration—and probably even this morning—as to how hard we are going to be, what position we should take on the gas pipeline, and particularly the position we are going to take on the reexports, the exports from the U.S. subsidiaries overseas, and the pressure we want to put on them.

The question is that, unfortunately, I feel we still have a chance to stop some of that. Even if we slow that pipeline down by 12 or 18 months, that means 12 or 18 months that they are unable to get the hard currency that pipeline will provide them. It is going to mean that at least we will slow that down, and we will put the German and other foreign banks in a yet more precarious position. They are worried right now, and if we can just slow down the hard currency that that pipeline is going to produce, I am much more concerned about the hard currency than I am about 6 percent of the natural gas. It is the hard currency that the Soviets need.

Right now they are selling gold. As you know, they are selling other hard assets. And the Polish debt would simply be one more step in order to put more pressure on the system.

My question to you—I see that you might want to respond to a couple of things I have said. It seems to me the key to this whole thing is that it is our money, our credits, to the Soviet satellite countries which have allowed the Soviet Union to spend its money on an incredible defense buildup.

SOVIET MILITARY BUILDUP

There is one more link here, the armaments, the tanks, the work that the Soviet Union is doing. We are in a way through our credits building infrastructure, providing the food and trade to the satellites, which means the Soviets don't have to do that, and they use their money, their credits, and their assets available to them for this unprecedented military buildup. That is one link that I would like for you to go through with me.

Mr. NOWAK. Well, we all know that the West pumped into the Soviet orbit more than $80 billion since 1975. I believe it is much more than the Marshall Plan. And this kind of injection did make possible for the Soviet Union first to avoid any kind of internal reforms, and second, to concentrate on armaments. I believe that the Soviet military buildup was largely financed by the Western credits, and I think that Poland can become a very important catalyst in this.

I think that even if the Government does nothing, the banks will be much more careful in giving credits to the Soviet orbit, and they may be indeed in considerable economic difficulties in the years to come, but again, it all depends on our policy to a great extent, and this is not just a question of the Polish people. It is a problem of the entire international balance of power.

IMPORTANCE OF POLISH PEOPLE

Senator KASTEN. I made a statement about the importance of the Polish people, and I think it is important to understand that what I meant is in terms of any kind of a temporary split in the Alliance. Obviously, the NATO Alliance is every bit as important, but as you just pointed out, the question is, right this moment, the importance of the Polish people.

We can afford a small rift in the Alliance overall. Obviously, the NATO Alliance is the most critical Alliance that we have, and we want to keep it strong.

Mr. NOWAK. I agree, Mr. Senator, with your remarks, and I share your optimism. I don't believe that the game is lost. Just the opposite. I believe that it may be the beginning of very important processes. I would not like to create the impression of some kind of unfairness toward this and previous administrations.

Indeed, if you compare the response to what happened in Poland with what happened at the time of President Johnson and the invasion of Czechoslovakia, and before that in the time of the Eisenhower administration, at the time of Hungary, one may say that both the administrations, Carter's and this one, have done all they could to at least try to warn the Soviet Union against invading Poland, and in this respect there is some kind of success, because there is an invasion by proxy, so that all that could have been done to deter the Soviet Union before December 13 was done, in my view, and also even after December 13.

Without the Reagan decisions, without the initial steps, there would be simply absolutely nothing. I am sure that the allies wouldn't even make this symbolic gesture that they have made with such considerable delay.

EFFECT OF POLISH DEFAULT ON POLISH PEOPLE

Senator KASTEN. A number of people have said that the declaration of default on Polish debt could possibly have an even more disastrous effect on the lives of the Polish people. In other words, if we did declare default, then there may be an invasion or there may be a further crackdown, and the Soviets would use the default as an excuse.

That point of view is shared by some people in this administration, and they have testified before this committee that it would give them an excuse, that somehow America would be blamed by the Polish people for making their lives even more difficult and more miserable.

Could you comment on that?

Mr. NOWAK. I am guided in this respect by Solidarity, which represents 10 million Polish people, and with their families even more, and if you include the rural Solidarity, 14 million people. Now, although they

have no coordination of their statement, they are unanimous in, first, supporting sanctions, and second, to use sanctions of their own. They do realize that in the short run people will suffer, and the people are aware of it, but this is the only way to avoid something much worse in the long run.

ACTIONS BY CATHOLIC CHURCH

In other words, only in this way can they really compel the authorities to go back to some kind of economic reforms which would make the system more efficient and working, and one should not be guided by the church in this respect. In the first place, the church cannot possibly support the sanction. That would mean that they would break any communication with the authorities, and they must be there, because they are the only remaining spokesman for any kind of dialog.

Also, it would be wrong to expect that the Pope would openly support a political measure of any kind. He can argue only from the purely moral point of view.

Senator KASTEN. I would like to thank you for your statement, and express to you how much we appreciate you agreeing to be with us today. There may, Mr. Nowak, be additional questions from other Senators who were unable to be with us today. We will forward those questions to you in writing and hope that you could respond in writing for the purposes of our record. I thank you again for your testimony.

INTRODUCTION OF AMBASSADOR RURARZ

I would like now to ask Ambassador Rurarz to come forward. Mr. Ambassador, it is a great privilege for us to have you here. The courageous position that you and your countrymen have taken, but you personally, I know is a great sacrifice. It is interesting to me that here we are in a room with two people, maybe more than two, whose lives could be in danger. Clearly, under different kinds of circumstances, right now you and others could be under detention or worse.

It is my understanding that even here in this room we have representatives of the present Polish government. We have representatives of probably other Eastern satellite groups. It is just incredible to me to think that here we are in the United States of America, and how different it is right at this moment in Poland and throughout the Soviet bloc.

We are pleased to have you here, and if you could make just a brief comment—I know that you do not have a prepared statement—and then respond to a few questions.

FORMER POLISH AMBASSADOR TO JAPAN

STATEMENT OF HON. ZDZISLAW RURARZ

WEST BEING TESTED

Ambassador RURARZ. I thank you, Mr. Chairman, for your kind words, and may I say that by deciding on the steps which I took, I just decided not to retreat before anybody or anything, and I am not deterred by anybody's presence in this room, and I would be speaking my mind, as much as I believe in.

Now, when it comes to the few remarks which I am going to make, may I say that I fully share what Mr. Nowak, my predecessor, said, and what you, Mr. Chairman, were saying, but let me add this. Right now the Soviets and the Polish military junta is putting the free countries before a test. When they were deciding to start with the military crackdown, they certainly knew very well what Poland's economic situation was. Not only the GNP was dropping for the second consecutive year, but at the same time they knew that, for instance, for this year only, 1982, Poland would need, as Mr. Nowak was saying, $16 billion in rescheduling of new credits, and certainly they must have known that by the military crackdown, the free countries would be unwilling to come to Poland's help to the extent as originally they believed it would be necessary. I mean, the $16 billion of rescheduling of new credits.

Nevertheless, they have decided on a crackdown. I must say that from the very beginning they calculated, and unfortunately those traitors from the military junta, they sided with the Soviet view that the Polish nation must suffer and must pay a very high price for the would-be restoration of socialism and alliance with the U.S.S.R., which, by the way, were never that much threatened by the Solidarity activities and the other democratic forces, because they were quite realistic, and they knew that there were certain limits to some of the changes in Poland.

Nevertheless, they have decided to make the Polish people suffer. Now, they try to make the free countries the hostage of the Polish difficulties, and they are complaining that if the United States would be not proceeding with the sanctions, and if some of those sanctions were not followed by other Western countries, of course, the Polish people would be living better.

Mr. Chairman, may I say this? Only during this visit by Jaruzelski in Moscow, he is saying that Poland will continue on their Marxist-Leninist science path.

MARXISM-LENINISM THEORY

Mr. Chairman, I belong to those who know Marxism-Leninism not only in theory but in practice. I myself have read Lenin three times. I could quote from my memory various, let's say, would-be thoughts by Lenin. Believe me, there is no science of Marxism-Leninism. This is a complete misunderstanding. This is the sick ideology serving the Soviet imperialist interests.

Therefore, there is no chance that any improvement in Poland would happen under the would-be socialism and the alliance with the

U.S.S.R., and especially if the military junta stays. Poland would be practicing the state of war.

But I am not even that formalistic, and I believe that even if Jaruzelski is replaced by a civilian and a state of war is officially lifted, then there are other measures, the arsenal here is very rich, and there might be some restoration of Stalinism or something like that which formally would be not a state of war or military junta.

So there is no chance of any improvement in Poland as long as the military junta and the communists of Poland are following the Soviet orders as they seem to follow very dutifully.

POLAND'S ROLE IN EAST-WEST WAR IN EUROPE

Therefore, there is now a crucial test before the West: What to do. I largely agree with what Mr. Nowak already said. May I say that I know very well what would be the role of Poland in the situation of war against NATO countries. The Polish army is supposed to be the so-called second wave of attack against Western Europe. The Soviets know too well how much value the Polish army is to the Soviet objectives during a blitzkrieg against the West. Therefore, they would be doing absolutely everything to have this army operational and following Soviet orders.

Certainly, the situation in Poland makes that army hardly operational for Soviet purposes. If the situation in Poland stays difficult and even more difficult than it is at present, the Soviet strategy, military objectives, against the West are greatly foiled. Therefore, I believe the West should do everything that is possible to make the situation for the Soviets as difficult as possible by refusing them and, of course, the Polish military junta, any economic help.

POLAND'S INDEBTEDNESS

Coming to Poland's debts, well, I think that Poland technically is already in default. You cannot prolong that situation for an indefinite period of time, that somebody would be somehow refinancing Poland's debt. Certainly, this is not helpful to you, and this is not helpful to Poland herself.

May I say this, that within the Polish establishment there is a belief that whatever they will be doing, always the world would be bailing out of trouble Poland because they believe that everybody is interested in having peace in Poland. So they probably were also counting on, during the military crackdown that the West would be coming to the economic rescue of Poland.

It does not matter what has happened to the basic civil rights and human rights and so on in Poland. They were believing this, and now they see that this is not so. Probably this is not 100 percent as it should be, but nevertheless, they are angry, and even Jaruzelski back in Moscow is speaking out. He is angered that the United States, the West, is making his situation difficult.

So let him be even more angry. I would definitely, definitely, not be helping him in overcoming Polish economic difficulties. That is the first thing.

Second, the Polish nation may believe if there is some, let us say, rescue operation without saying to the military junta, what are the preferences of the free countries and especially the United States, then the Polish nation may believe that something is going behind the scenes, that there is some rhetoric publicly used but that is for, let us say, public consumption, but in reality the U.S. Government and other governments of the Western countries are really siding with Jaruzelski.

This would be morally disarming the Polish nation. You should not be doing that. Therefore, I would be strongly advocating making legal all debt that is already technically done. I mean default. And just to trigger the chain reaction that the Western countries, some of them, who were too overly optimistic when it comes to Poland's ability to repay the credits, let them suffer.

MARKET ECONOMY PHILOSOPHY

As far as I understand the philosophy of the market economy, and I think I do, the main, I would say, philosophy of that functioning of market economy is a risk. If certain commercial private banks were irresponsible by extending their credits, believing that the U.S.S.R. would be bailing out those countries or somebody else would somehow, let them suffer.

This is the philosophy of the market forces of operation. Now, the same is true about the credits for the others. As Mr. Nowak was saying, you are subsidizing the system which is falling apart. That system is highly economically inefficient. It is an oppressive system. It will never function properly even if you would be pumping more money in it. It would continue to be aggressive and to be oppressive.

For how long you are going to continue that game? Because if you are coming to a rescue, not declaring some of the countries in default, and provoking this chain reaction, you are at the same time obliged to subsidize that system further as the Western Europeans are trying to do with the gas pipeline, believing that Mother Earth would probably be repaying sometime in the future the credits they are now giving.

I do not think they would be seeing that money back because what they would do to the Soviets if the Soviets would say, no, sorry, we will not be repaying anything to you. I do not know what they would do. Besides, they would be providing them with money which would be used for military ends.

So this is something which is certainly to be stopped. You do not have three options. There are only two options: Either you will stop subsidizing debt which absolutely must bring about a death of the system which is totally inefficient; or you will simply subsidize it. For how long? Well, I do not know. For as long as probably the taxpayers and other foolish banks will be ready to subsidize.

IMPOSITION OF GRAIN EMBARGO TO U.S.S.R.

I do not know. This is something which you must decide and you must decide quickly to foil the gas pipeline deal. And just let me end my remarks with this. I am strongly voicing imposing the grain embargo on the U.S.S.R.

You are, Mr. Chairman, supposed to increase your defense spending only this year by $33 billion if this is adopted by the Congress. The grains, the 23 million tons you are supposed to sell to the Soviets, are worth something like $6 billion. Besides, the Soviets, as far as I know, are looking for credits in the West to buy your grains.

Well, I would reduce that increase in military spending by the equivalent of this grain exports and pay out to the farmers. The net effect of that operation would be far greater than to increase the defense spending and sell grains at the same time.

I do not agree with that argument by some here in the United States that if you do not sell this grain, then the others will sell it. This is the feed grains which you have, and the Soviets mostly need feed grains, and the others do not have the feed grains. That much, at least, the United States does have. You have to complicate the situation for the U.S.S.R., for the would-be socialism in general, if you are going to win. Otherwise, I do not think there is any end of debt more to competition between the free world and the U.S.S.R.

Thank you very much, Mr. Chairman.

Senator KASTEN. Mr. Ambassador, thank you very much.

As you know, the question of the grain embargo and the effectiveness of it has been debated. There are a number of people who feel that all we did essentially was disrupt the supply for a short period of time. And then the supply was filled by Canada, Argentina, and others. There are others who feel as you do, that because of the quality or the type of grain that we have, we can make a serious dent in their economy, and in their efforts for a longer period of time.

Mr. Nagorski has written an article in the Wall Street Journal, in which he says the reasons for the present crisis are rooted in the unjust and unfair conditions of our—"our" being the Polish foreign trade—conditions which would be described as robbing Poland of its hard currency reserves.

Now, basically, what Mr. Nagorski is saying is that a system set up in 1976 was based on an economic unit called a transferrable ruble, which resulted in Poland footing the hard currency bill for large portions of the Soviets' imports of goods and technology.

TRANSFERRABLE RUBLE

Is this an accurate description of the trading system between the Soviet Union and Poland, as a result of this so-called transferrable ruble unit?

Ambassador RURARZ. Yes, Mr. Chairman. I am familiar with that article by Mr. Nagorski, and I was already explaining to some of the experts here in the United States, the situation is by far even more complicated than that. I would not be attaching a great importance to certain, I would say, technical problems, which is this transferrability of the ruble, which by the way does not exist in practice.

But may I say this, that this goes far beyond all that. Certainly, Poland was throughout the postwar period encouraged to develop certain industries and to increase certain spendings which have absolutely

nothing to do with the preferences of the Polish people and of the Polish economy.

This is not a recent phenomenon, what Mr. Nagorski is writing. We have been compelled in the postwar period to expand the war industry, for instance, which is absolutely serving no purpose for the Polish economy. This is a great burden upon it. We are maintaining a large army, the third largest in Europe after the Soviet and West German army, which is also serving no purpose except oppressing the Polish people.

SOCIALISM OF POLAND'S AGRICULTURAL PRODUCTION

We have also been encouraged to practice socialism in the most orthodox form, which really brought about all this collapse of the Polish economy. Poland has become a net importer of food. Why? Because it was toying with this socialist idea of making the farming state-owned, and the individual farmers were very much discouraged, so that we have this food problem on purely ideological grounds, and besides, very much pressed by the Soviets, I say with some authority, because I was quite close to all of those things.

And there are many, many other things of that kind. Also, of course, the inputs of certain goods exported to the U.S.S.R. are very much burdened with hard currency imports. This is, of course, very well known in trade. Besides, the U.S.S.R. was never too much interested in making exploration, possibilities to produce natural gas and oil, because there are some reserves of that, because they wanted to make Poland dependent on them, and many, many other things.

So this, Mr. Chairman, is far more complicated. Besides, may I say that I presented a paper on that, when it comes to some philosophical, I would say, assessment of how Poland is exploited by being allied with the U.S.S.R. and socialism. You might look into that paper.

ECONOMIC RELATIONSHIP OF U.S.S.R. AND SATELLITE NATIONS

Senator KASTEN. You described the economic relationship between Poland and the Soviet Union. In your opinion, does that same economic relationship hold for the other satellite countries, in that their economies are essentially being controlled and managed for the benefit of the Soviet Union, and that the hard currency problem exists in the same way?

Ambassador RURARZ. Exactly. Each so-called 5-year, or in the past it was 6-year, plan before it is even discussed by the Polish authorities is consulted with the Soviet State Planning Commission. And only after receiving their views on that, the draft of the plan is prepared and it goes for further consideration by the Polish authorities.

So that at the original stage of preparing the development of the plan, there is very close consultation with the U.S.S.R., which is, of course, voicing its preferences.

May I say that the State Planning Commission in the U.S.S.R., 80 percent is composed of military, so that the military considerations are certainly dominating here. So that Poland is fitting, I would say, within this war machine by the U.S.S.R., and this is decisive.

SOVIET REACTION TO POLISH DEFAULT

Senator KASTEN. How do you believe the Soviet Union would react to a declaration of default? Specifically, do you think that it would be forced to use more of its resources to shore up Poland, to help them more economically? Or do you think it would merely allow the Polish people to continue to suffer the consequences?

In other words, by declaring default, do you think the Soviets would move to try to shore up that economic loss that would be produced? Or do you think that they would simply let the Polish people and the government there suffer the consequences?

Ambassador RURARZ. Well, Mr. Chairman, the Polish people are suffering anyway. And I am afraid that it may suffer even more in the future, even if, let us say, the material well-being of the nation would not be deteriorating further.

But morally and spiritually, that nation would suffer for probably a long time. And I am not excluding bloodshed, because the people may be brought to desperation and may quite simply take to the streets and start fighting. Well, I am not excluding that. Besides, the nation has the right to strike back if it is abused in that way that it is.

But coming back, well, I think that the Polish economy is that important to the U.S.S.R. It is very much interlinked with the Soviet war potential that the Soviets will be trying to do everything that is possible, of course, not to make that economy totally collapse.

There are also limits to the suffering of the Polish people. They would certainly be trying to do as much as possible not to make the Polish people starve on a mass scale, because of course, the Polish army and even the security police is composed of Poles, first of all. So they, when certain limits are crossed, they also may be revolting. This is not totally impossible.

EXTENT OF SOVIET AID TO POLAND

There is another problem: Whether the Soviets can really help. I must say that I am rather very much of the opinion that the Soviets would be unable to help Poland much. As far as I can figure out, their current exchange reserves are very small. I think they are only $3.7 billion, what is known. What their gold storage is is unknown, but even if the estimates are true, even if it is up to $10 billion, although the estimates vary between $2 and $10 billion, if they were to start selling gold on a mass scale, they would drive down the price of gold.

Senator KASTEN. It is already happening, I think.

Ambassador RURARZ. Yes; they would be asking for some new credits. That is certainly again a problem.

When it comes to their own resources, they cannot provide Poland with food, especially grains. They cannot provide Poland with many spare parts and components because the Polish industry, especially that built in the 1970's, is more than 50 percent based on Western technology and Western capital goods and so on and so forth.

And I think that the Soviets were not planning that kind of help in the past, so that this would certainly displace a lot of Soviet, I would say, economic strategies if they would be obliged to do that. And I do

not believe that other Eastern European countries would be able to help Poland.

I would, nevertheless, suggest and recommend very strongly to make a test of what the Soviets would do if you would do what I think many people advocate here. And I strongly subscribe that somebody must take the lead, and somebody must show the way of how to treat them by, of course, refusing the credits and by making them default. Let us see what will come next.

I do not think really the Soviets are capable of helping Poland as much as they would wish. I am not saying what the Polish people would wish; that is another story. Certainly, they would be unable. But even they themselves, they are unable to do that.

Mr. Chairman, may I say that they are maintaining the oil supplies to Poland only at the expense of cutting those supplies to Czechoslovakia and to some other Eastern European countries, because they are unable to produce more oil.

INTERNATIONAL DEFAULT

Senator KASTEN. Mr. Ambassador, I thank you very much for your testimony. And I think it is important that someone take the lead on this issue.

It is my hope that through the work that you are doing, through the legislation I am going to introduce this afternoon, and through additional hearings we will have an impact.

What is an international default? In other words, is it like personal bankruptcy in which you can wipe out your debts, or do those debts remain? In the next week or so we are going to be examining that question.

We have not had an international default before. We have not had a country go into default, but we will examine that question with some international bankers.

In my opinion, the Soviet Union would have no choice but to try to move in. And it would divert resources, whether it would be from Czechoslovakia or other Eastern European countries, as you say, or whether they would be forced to divert resources from the military or they would be forced to further draw down on their gold, their diamonds or their hard currency.

But one way or the other, it seems to me that in all cases the result is one that would overall be of benefit to us. I believe, although there may be some short-term problems, overall it would be of benefit to the people of Poland and to the courage and belief that you at this moment so personally demonstrate.

We thank you for your testimony this morning.

Ambassador RURARZ. I thank you very much, Mr. Chairman. And let me say that I am greatly honored to have been given the chance to testify before you. Thank you very much.

Senator KASTEN. I thank you very much.

The final witness is Mr. Karpinski.

Mr. Karpinski, would you come forward? It is my understanding that you have a prepared statement that you may wish to excerpt parts of,

and then respond to questions. It is a great honor for us to have you here. Would you please go forward with your statement?

YALE UNIVERSITY

STATEMENT OF WOJCIECH KARPINSKI, VISITING PROFESSOR, YALE UNIVERSITY; MEMBER, SOLIDARITY

PRESENT AND FUTURE ROLE OF SOLIDARITY IN POLISH SOCIETY

Mr. KARPINSKI. Mr. Chairman, I would like to thank you for giving me the opportunity to speak here today. I would like to discuss the present and future role of Solidarity in the life of Polish society, and the way in which the United States may help the Polish people to overcome the present crisis.

In order to understand the present situation in Poland, it is important to understand the nature of the Solidarity Union, the way in which it came to exist, the form of its past and present activities and its possible future role.

Solidarity was a democratic union organization, independent of the authorities. It expressed the diverse aspirations of a society in the process of civic rebirth. It renounced violence and demanded respect for the rights of the individual. It is for this reason that Solidarity was so important.

The political and social systems of Eastern Europe do not function effectively. The economic catastrophe of the last few years is only the most spectacular event in a long series of economic defeats. Economic reforms are absolutely necessary in the Communist countries, but in accordance with Leninist practice, economic life in those countries is subordinated to political concerns.

Despite the claims of the authorities, the course of the economic catastrophe in Poland did not lie in the workers' strikes, but in the absurd system of centralized decisionmaking distribution. No one knew the rational price of any product. No one could determine the basic factors of production. There was thus no real money, no real planning, no real market, except, of course, for the flourishing black market.

It is about the authorities that one may justly say that they were on strike ever since the beginning of Solidarity. They opposed all reform and did not allow anyone else—above all, Solidarity—to influence the essential economic decisions. Billions flowed in from the West without any political conditions, without any control over the economic and social consequences of the loans. They were spent on the strengthening and expanding of the gigantic mechanism of waste.

NOMENKLATURA

Why were the authorities in Poland so stubbornly opposed to a genuine reform? That a reform was necessary was also emphasized by the Communist Party, but any real reform meant the acceptance of economic and political criteria of decisionmaking—that is, the acceptance of a measure of institutionalized and permanent social control over the

economy. This in turn would mean the limitation of the party monopoly of power and end of the so-called nomenklatura, which became one of the pillars of the Community authority.

In the Communist countries, nomenklatura is a formalized system reserving for the party control over all the important positions, not only in the political but also in the economic and social domains. Every manager of every factory must be nominated by the party. We are thus dealing with a process of negative selection which rewards not professional competence but unquestioning obedience.

The power to make decisions remains within the party, but at the cost of economic and social disintegration. At any moment there exists the danger of an outburst of popular discontent. Only the introduction of independent channels for the expression and moderation of social tensions could permanently contribute to the state of balance in the countries of the Eastern bloc.

EFFECT OF SOLIDARITY ON COMMUNIST BLOC NATIONS

Solidarity appeared in answer to such concerns. Solidarity was a force designed to moderate conflicts, but it could have been effective in this task only if it had been permanently accepted by the authorities. To be sure, such acceptance would be a courageous step. No power likes to limit itself, and absolute power does not like it absolutely. But only in this way was it possible to make the economy work. This problem confronts all the states of the Communist bloc.

If they want to compete with the West, they must think about the economy. And no doubt they do want to compete, although not for the sake of their citizens' welfare but for the sake of their own power. To be successful in their task, however, the Communist authorities must release the creative potential of democratic social mechanisms. This in turn requires the absolute party monopoly of power be limited and that the existence of independent social forces be acknowledged, at least to a degree.

Solidarity presented the authorities with precisely this opportunity. It was an opportunity not only for the society, but also for its rulers. It offered a solution not only for Poland, but in principle also for other countries of the Eastern bloc.

The problems which gave birth to Solidarity still exist. Solidarity also still exists. Its roots in the Polish society are too deep to be destroyed in a single blow. Solidarity arose spontaneously out of local initiatives. It saw the greatest danger in centralization and secret decisionmaking. Solidarity's total openness made its leadership vulnerable to a sudden attack. It was possible to paralyze the leadership in the first few days of martial law. But by the same token, the arrest of its leaders is not tantamount to the destruction of Solidarity itself. It still exists and organizes resistance to the militarization of the Polish society, and it will be active in the future.

It is impossible to introduce real reforms, to revive the market mechanisms, without broader social support, and thus without the support of Solidarity. At this moment we are witnessing the waging of a war

against the people of Poland. We are farther than in August 1980 from the idea of a civil society, but the rebirth of a civil society is a necessary condition for the economic rebirth of Poland.

I do not know what the next move of the authorities will be. In the long term, I am afraid they do not know it either. I know, however, that the situation in Poland constitutes a threat to the social stability inside Poland, and to the peace in Europe. Only Solidarity can prevent desperate social explosions in Poland.

U.S. SUPPORT OF SOLIDARITY

What can the United States do? It can support those who defend the Polish society and national reconciliation. Means could be perhaps devised of conferring on Solidarity and its leaders a form of official recognition as spokesmen for the political aspirations of the Polish people. American trade unions and other professional groups and associations could also devise institutionalized forms of such recognition. And, above all, the communication blackout of Poland should be overcome. All radio stations broadcasting to Poland should be able to increase the capacity, since they now constitute the only source of reliable information for many Poles.

Sanctions should be directed not at the Polish people but at those, both in Moscow and Warsaw, who are responsible for the introduction of martial law. In choosing the proper targets of Western sanctions, one should not engage in speculations as to who is liberal and who is a hardliner, but should look into the operating political mechanisms and their effects, into the forces that may contribute to the abolition of martial law. Also, sanctions should be directed at the soft spots of the Soviet empire—for example, high technology. They should be counterbalanced by an offer of generous and long-term aid, on the model of the Marshall Plan, conditioned upon the introduction of the significant political reforms and the recognition of the independent social forces in Poland.

Thank you very much.

INDEPENDENT CHANNELS

Senator KASTEN. Thank you very much, and I am very pleased with your statement, particularly the statement you made about the independent channels that should be established for the expression and the modernization, as you say, of social tensions.

To what degree are these kinds of independent channels being established in other Eastern bloc countries?

Mr. KARPINSKI. You know of course that the situation of Poland was special and to some degree exceptional. So there is nothing comparable to Solidarity in other Eastern European countries. And I am afraid that there is not even the beginning of a similar movement in other countries. But on the other hand, there are independent groups acting there.

The situation is different in different countries. I think that Hungary is, to a great degree, similar to Poland let us say in 1972 or 1973. In Czechoslovakia, where political terror is really very serious, I think that

most of the population is, as in the other Communist countries, against the regime, but it is impossible to organize outspoken groups, even small groups, which would act.

INDEPENDENT MOVEMENTS IN U.S.S.R.

But what is for us maybe even more interesting, in the Soviet Union there is also a movement, a very limited one but nevertheless there is one, in the direction of the creation of those independent channels of expressing public opinion. And also the situation is different in different parts of the Soviet Union. We are witnessing the creation of the first forms of something like the beginning of the trade union in Latvia, in the Baltic states. There is a hope for a different movement, religious-based, in Moslem countries of the south. There is a nationalistic movement in the Ukraine.

But the situation is still different from what it is in Poland. I think Poland is a kind of experiment. Why in my opinion the situation in Poland since 1976 was so important for the entire future development in Europe, and one could say in the world, is that all this movement in Poland, and first of all Solidarity, was the first try to get out of a totalitarian form of regime which was forced upon those countries after World War II and which did not function. And sooner or later this question will appear: How to change these regimes, how to make their economies function. And to make their economies function you have to introduce some democratic mechanisms.

So I can say that in the long run I am optimistic. I believe that some changes will be introduced, but now, as I look at the situation in Poland, I see for the time being no sign of improvement by the Jaruzelski regime.

DETENTION OF SOLIDARITY MEMBERS IN POLAND

Senator KASTEN. You were in the United States, in New York I think your statement said, at the time that the crackdown occurred. We are told that there are maybe more than 5,000 people who are still being detained in one form or another, in jails or concentration camps or whatever.

Are you now able to communicate with some of your friends and your associates? Are there more than 5,000 people being detained? And do you know anything about the circumstances under which these people are now forced to live?

Mr. KARPINSKI. First, I think one should stress that the information coming from Poland is extremely limited, and that this information blackout imposed by Jaruzelski was a very sure step, and to some extent in the beginning, a successful one. It is why I stress so very much that the Western countries should do everything to overcome this information blackout.

But yes, we have information about what is going on, not only in Poland but also in those internment camps. By "we" I mean a group of people, mostly from Solidarity, who are now organized in committees in support of Solidarity in the United States and also in Europe. There is

a committee in Paris and in Stockholm, where the communications with Poland are easier.

So in our estimation, the number of people being arrested is bigger than the official numbers given by the authorities.

You know, it is very hard to say precisely how much, but we know that not only in Warsaw but in provincial towns like Wroclaw, there were almost 1,000 people arrested. We have lists of people arrested. So one should suppose that this number is a very low estimation.

What are the conditions? The conditions vary in different camps. You know, people who are well known in Poland and also who are well known in the West are kept in better conditions. The communication with them is easier. But we are afraid mostly about the situation of workers from provincial towns. Nobody knows their names, so they are absolutely dependent on the regime, and they are armless now.

POLISH OPINION OF WEST

Senator KASTEN. How would you characterize the feeling among the Polish people vis-a-vis the Soviet Union, and also how would you characterize the feelings, pro and anti, toward the West in general?

There was an article published in the Washington Post last year by Deputy Prime Minister Rakowski in which he discussed the anti-Soviet factions in Poland and also the pro-Soviet factions in Poland. How would you characterize the feelings of the Poles now? Obviously Solidarity's feelings might be somewhat different, but what kind of a situation do we have in terms of these feelings? You might even be familiar with that article.

Mr. KARPINSKI. Yes, I think so. To answer your question, one should speak about a little different situation before the introduction of martial law and after the introduction of martial law. Of course it is a mystery to nobody that we have been since 1945 under Soviet domination, and no nation likes such a situation. It is obvious.

But when Solidarity appeared, I think this union, this organization, was very susceptible not to provoke any purely propagandistic or emotional anti-Soviet, anti-Russian expressions. And I think that Solidarity leaders had to even keep low the sentiments of the mass members of Solidarity, sentiments which were more against the Soviet domination in Poland.

And now, after martial law, after this state of war, of war against the Polish people, it is obvious that those feelings, anti-Soviet, are stronger and are overwhelming. I do not believe any segment of the population is now pro-Soviet. Only those members of the junta, of the establishment that depends on the Soviet Union are pro-Soviet, but nobody else.

And now the feelings about the West? Well, I do not think anyone had an illusion in Poland that at the moment of Soviet intervention, and it is a Soviet intervention by proxy, the Western world could and would like to intervene militarily. But I think that people now are looking with extreme tension at what are the reactions of the West, and they hope that those reactions will be as tough as possible. And I think

that the reaction is differentiated, as the reaction of the Western countries is differentiated.

I have not been in Poland so I cannot tell you surely, but I could imagine what the reaction toward German behavior is, and it is not a favorable reaction. And when you think about the Vice Premier Rakowski who is responsible for this coup in December being accepted by West Germany a few days after the events in Poland, it is something that you could not imagine after Czechoslovakia, after Hungary. So I think that it is something that is extremely resented by the Polish people now.

ROLE OF CHURCH IN POLISH SITUATION

Senator KASTEN. I just have one further question. I would like to explore your understanding of the current relationship between the church and the Polish government, and then specifically what, if any, role the church has played in the Solidarity movement?

Mr. KARPINSKI. You know, I think that Mr. Nowak's remarks about the church were very to the point, very important to understand, that the church of course now is the most important social force. It is the only one existing. But it is not and it could not be a purely political force. Given the conditions in which the church functions in Poland, it has political meaning, of course, but the church has to be on speaking terms with the authorities and cannot express loudly some ideas of some political solutions, which the church looks at with sympathy or with acceptance.

And now if you ask about the role of the church in the Solidarity movement, it is an interesting question and sometimes misunderstood in the West. I think that the church was a framework or created the conditions—not church as an institution but the church as Catholic believers in Poland—for the creation of Solidarity and for the development of Solidarity.

But Solidarity was very attentive not to be considered as a denominational organization, as a religious organization. It was clearly declared in Solidarity's documents. So the church only created a ground for the existence of Solidarity and was and still is an ally, the most important one, for Solidarity. But Solidarity is not a religious organization. The church in Poland is not a purely political organization.

Senator KASTEN. I would like to thank you for your testimony here this morning and to also echo to you the statements that I made to some of the other witnesses, that we appreciate your dedication, your courage, and the great respect that I personally have for what all of you are doing and working for.

Mr. KARPINSKI. Thank you very much.

Senator KASTEN. I congratulate you and I look forward to working with you in the future.

SUBCOMMITTEE RECESS

The subcommittee will stand in recess until March 10, at which time we will begin our regular budgetary hearings on the fiscal year 1983 foreign assistance program with the overview testimony from Secretary of State Alexander Haig.

The meeting is recessed.

[Whereupon, at 11:40 a.m., Tuesday, March 2, the subcommittee was recessed, to reconvene on March 10.]

POLISH DEBT CRISIS

TUESDAY, MARCH 16, 1982

U.S. SENATE,
SUBCOMMITTEE ON FOREIGN OPERATIONS,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 2:05 p.m., in room S-128, the Capitol, Hon. Robert W. Kasten, Jr. (chairman) presiding.

Present: Senators Kasten and D'Amato.

NONDEPARTMENTAL WITNESSES

OPENING STATEMENT OF SENATOR KASTEN

Senator KASTEN. The subcommittee will come to order.

This afternoon the subcommittee will have its third of an ongoing series of oversight hearings on the Polish debt situation. These hearings have been instrumental in keeping this issue in the forefront, not only with respect to Poland, but also with respect to U.S. policy toward the Soviet Union and the Eastern bloc.

It is gratifying to note that in testimony before this subcommittee on March 10, Secretary of State Alexander Haig indicated that the administration is keeping the default option open as a possible course of action toward the military dictatorship in Poland. The administration's willingness not to close the door on this option is encouraging, and it is with anticipation that we in the Congress, and particularly on this subcommittee await the mission headed by Under Secretary James Buckley which is currently in Europe to discuss this and other possible sanctions with our allies.

I think that the action taken by the administration and the State Department on the question of Romania's debt and whether or not they were going to be allowed to come up to the trough once more was significant; it was significant that they were refused. I think the fact that the Congress, both the House and the Senate, is taking a more aggressive attitude and is having an effect on the overall policy of this administration and particularly the Department of State.

We are fortunate once again to have some very distinguished witnesses to present testimony on this issue.

INTRODUCTION OF WITNESSES

Our first witness is Mr. Thomas Gleason, president of the International Longshoremen's Association, who is accompanied by Mr. Tom Kahn, assistant to Lane Kirkland, the president of the AFL–CIO.

I want to commend the AFL–CIO and the Longshoremen, in particular, for their consistent and untiring support of the labor movement in Poland and for their support of what I believe is a tough but reasonable foreign policy toward Poland, the Soviet Union and the Eastern bloc.

Our second witness will be the Hon. R. T. Davies, former U.S. Ambassador to Poland. Ambassador Davies, your expertise and experience in Poland will be of great interest to this subcommittee.

Our final witness for today is Dr. Jan Vanous, who is the senior economist of Wharton Econometric Forecasting Associates, Inc. Wharton's figures on the Polish debt situation in particular and more recently Romania's situation have been widely quoted. While I know that Dr. Vanous has a different opinion on the advisability of the default option, his testimony should present the subcommittee with valuable information which we can then use in our overall efforts to analyze the problem of credits and debts with the entire Soviet bloc, and the Soviet Union, in particular.

So, first of all, Mr. Gleason, I congratulate you on the strong statements you and others in your association have made. It is a privilege and a pleasure to have you here today, and I would like you to proceed with your testimony.

Mr. Thomas Gleason.

INTERNATIONAL LONGSHOREMEN'S ASSOCIATION, AFL–CIO

STATEMENT OF THOMAS W. GLEASON, PRESIDENT

ACCOMPANIED BY TOM KAHN, ASSISTANT TO THE PRESIDENT, AFL–CIO

SOVIET UNION RESPONSIBLE FOR POLISH REPRESSION

Mr. GLEASON. My name is Thomas W. Gleason, and I am president of the International Longshoremen's Association, AFL–CIO.

I welcome this opportunity to present the views of my union on the Polish debt issue. Our views are in complete accord with the positions taken by the AFL–CIO, whose president, Lane Kirkland, has authorized me to speak for him on this occasion.

When a state of war was declared in Poland on December 13, there were people in the West who refused to see this event for what it was, the brutal repression of Solidarity and of the reforms it had won.

Some saw the imposition of martial law as an alternative to a Soviet invasion, as if the Soviets were not the real authors of the crackdown.

Not only some European politicians, but American foreign policy experts like George Kennan saw the Polish junta as a force for moderation, which would preserve many of the reforms promised in the Gdansk agreement. They suggested that Solidarity had gone too far and warned against a harsh Western response to the crackdown.

This view was not shared by the AFL–CIO, and we were both pleased and relieved when the President of the United States in his televised Christmas message denounced the martial law, demanded the release of Lech Walesa and the other imprisoned Solidarity members, and placed the blame where it belonged, on the Soviet Union.

While we were pleased by the President's words, we were disappointed by the mild sanctions he announced against Poland.

AFL–CIO URGES STRONG MEASURES AGAINST SOVIETS AND POLAND

On December 28, in testimony before the Joint Commission on Security and Cooperation in Europe, the AFL–CIO urged the administration to take a number of strong steps against Poland and the Soviet Union for their assault on the human rights of the Polish people in violation of the Helsinki accords.

Among those steps we urged that the Polish debt be called in and that no further credit be extended to the Soviet Union or Eastern Europe.

The following day the President announced additional sanctions, some of which we had recommended, and the AFL–CIO welcomed these sanctions, even though they fell short of our demands.

At that time the President promised stronger measures if the situation in Poland did not improve.

He repeated this warning again on January 19 and on January 30 before an international television audience of 160 million.

DETERIORATION OF SITUATION IN POLAND

Mr. Chairman, the situation in Poland has not improved since the President spoke. It has deteriorated.

Lech Walesa remains a prisoner and the Polish government refuses to negotiate with him in the presence of his advisers and colleagues.

Workers are being sentenced to jail terms. Thousands of Solidarity activists are being threatened with deportation. Polish citizens are being pressured to sign loyalty oaths. The authorities have made it clear that they have no intention of lifting martial law.

CALLING IN THE POLISH DEBT

Still, the President has not come forth with the additional sanctions he promised. Instead, the administration has thrown out one of the most effective weapons at its disposal, the weapon we urged it to use 2½ months ago, calling in the Polish debt.

At its February meeting, the AFL–CIO Executive Council criticized the administration for covering the $71 million owed by the Polish government to American banks while skirting a regulation that would have required that Poland's debt be declared in default.

As the council pointed out:

> The effect of calling in the Polish debt would be to dry up the flow of easy credit to the Soviet bloc, cripple the construction of the Siberian gas pipeline and the stem the diversion of resources into Moscow's military buildup. This is precisely the cost the West should impose on the Soviet Union. • • •

We are told by the administration that a declaration of default would relieve pressure on Poland and the Soviet Union to repay the Polish debt which now amounts to $27 billion. But who can believe that Poland, on the verge of bankruptcy, can repay that debt?

And what reason is there to believe that the Soviets will cover these loans? The administration has repeatedly told us how sick the Soviet economy is.

Another argument against default is that it would disrupt the international banking system, so large is its investment in the Soviet bloc. But as the executive council stated:

> The estimates of the dislocation are exaggerated and self-serving; they are suspect coming from bankers who claim handsome rewards for risktaking but immunity from the penalties of bad judgment.

WESTERN LOANS TO EASTERN BLOC COUNTRIES

This, Mr. Chairman, is the essence of the matter. Western banks have lent $70 billion to Russia's European satellites. These were bad loans to begin with. They were based on the cynical assumption that Communist societies are stable and orderly, and that, in any case, if the banks got into trouble, their governments or the Soviet Union would bail them out.

Unfortunately, there is a price to be paid for bad judgment, but the banks don't want to pay that price. They want the taxpayers to foot the bill while they continue to carry these bad loans as assets rather than as liabilities.

As the Economist put it: "Western bankers are unwilling to chop off these imprudent loans lest this looks ugly on their balance sheets."

The Wall Street Journal, which certainly knows the banking business agrees: "They have refrained from declaring a default in Poland because the writedowns would hurt their earnings."

U.S. POLICY TOWARD SOVIET BLOC COUNTRIES

The issue here, Mr. Chairman, is whether American policy toward Poland and the Soviet bloc should be determined by the priorities of the bankers.

I believe that where questions of human freedom are at stake we cannot look to bankers for guidance.

What guidance can we get from Citibank, where Vice President Thomas Theobald says: "Who knows what political system works best? All we ask is can they pay their bills?"

And what can we learn about human rights from David Rockefeller who says: "I don't think an international bank such as ours ought to try to set itself up as a judge of what kind of a government a country wishes to have. We have found that we can deal with just about any kind of government, provided they are orderly and responsible."

Mr. Chairman, David Rockefeller and his bank may be able to deal with any kind of government, but the AFL–CIO cannot. Our dealings are not with governments but with workers with free trade union movements.

The bankers want to do their business with the Polish government. We want to do business with Solidarity. We are not allowed to do our business. We are prevented from working with Solidarity by the Polish government that the bankers want to work with.

We are interested in restoring the human rights of the Polish people. The bankers are interested in underwriting with workers' tax money the jailing of Lech Walesa.

American workers who are told that there is no money for unemployment benefits, food stamps, and other social programs are being asked to fork over $400 million in guaranteed bank loans to the Polish junta.

We regret that the administration has chosen to listen to the bankers rather than to its own declarations of support for the Polish workers.

We commend you, Mr. Chairman, for your own efforts to reverse the administration's policy on default. The AFL–CIO will continue to support legislative action toward this end.

Thank you.

Senator KASTEN. Well, I thank you very much.

I know you are accompanied by Mr. Tom Kahn.

Tom, do you have any statement to add?

Mr. Kahn. No; but I would be happy to respond to your questions.

Senator KASTEN. First of all, Mr. Gleason, at the end of your testimony you mentioned over $400 million in guaranteed bank loans. It is our information now that the Commodity Credit Corporation on a schedule which we have found is in the process of spending $876 million on a month-by-month basis, starting off with the $71 million that was spent in February in order to bail out these loans, interest and principal in order to keep these loans from going into default. So it is well over $400 million and it could be close to double that, and it simply points up the importance of this problem.

As your statement so eloquently points out, the situation in Poland has not improved. It has deteriorated. Several weeks ago this subcommittee heard from a Solidarity member, Mr. Karpinski, who happened to be in this country when martial law was imposed, and the significance of that was that the day martial law was imposed there were already lists of people to be detained, lists which had been printed and had been distributed.

So it isn't as if this thing happened suddenly, and it was all done within Poland itself. There is clear evidence that the people who are currently in the Polish government are merely Soviet puppets, and this is not a Polish government but a government run by Soviet proxies.

His name was on a list of people to be arrested. They came to his house and they arrested his son of the same name. He happened to be in New York that day, and he is now a visiting professor at Yale.

RETENTIONS OF SOLIDARITY MEMBERS IN POLAND

Mr. Karpinski stated: "The number of people being arrested is bigger than the official numbers being given by the authorities."

He also expressed concern for those less well-known workers who were arrested in some of the provincial towns. He said, "Nobody knows

their names, so they are absolutely dependent on the regime and they are armless now."

There were some of the key members, and we knew their names and their whereabouts, but there are a large number of workers who weren't as prominent and therefore we know little or nothing about them.

I know that you have through a number of channels the ability to communicate with Solidarity and are in touch with the difficulties and the problems there. Would your information coincide with that of Mr. Karpinski in that there are many more people who have been detained, particularly in these provincial towns?

Mr. GLEASON. Oh, there is no question about that. The records in the AFL–CIO have that, that the number of people are far greater than what they admit. Tom would know that a little bit better than I do.

As you know, we are not handling any Polish cargo in or out. We don't touch it in or out. We have allowed food stuffs to go through, probably going to Care and Catholic charities or the International Red Cross.

When we only solicited and shipped to these three concerns their food packages, we found out that we were getting form letters. I received about 500 form letters in my office condemning me for stopping food from going to Poland. We were stopping the food from going because it wasn't going through these three agencies, and we didn't want the government to take charge of this food and use it.

The funny part of this food was that the Poles before December 13 shipped enormous shipments of ham to here in this country into all limits of the Polish area where the Polish people, and I happen to have a Polish daughter-in-law, but it went into all these neighborhoods where the Polish people would buy these hams up as food and then send them back. They got the hard currency for shipping the hams over here and then they made the money going back.

Some of these consolidators, not shipping companies, but consolidators on the outside who were probably working with the government for this distribution of this food were around criticizing us because we weren't allowing it to move through the three agencies we told you about. They criticized us and took ads in the paper about even Hitler let food go through, they said, and condemned that it was a massacre stopping this food.

We found out now that some of this food is being taken over by the government. We have a statement here and I guess you have the final report. Did you see this statement where this food is being commandeered by the Polish government and it is not going to the people who it is consigned to.

Senator KASTEN. This statement is not familar to us. With unanimous consent, I would like to have this statement made a part of the record at this point.

[The statement follows:]

[The Economist Newspaper, Feb. 11, 1982]

CONFIDENTIAL—FOREIGN REPORT

HOW TO PURLOIN AID PACKAGES

Poland's military rulers are apparently diverting much Western assistance—food, winter clothing, and essential medicines—into their own hands. Since the first days of martial law, the underground Solidarity leadership has urged that foreign aid should go through the Roman Catholic church. Western aid-givers are making a point of not sending anything to the government. But the regime has found ways of getting its hands on at least part of the aid.

The Jaruzelski regime would like to take control of the whole relief operation partly because it urgently needs supplies to keep the army well fed. According to our informants, there seems little doubt that a large proportion of aid sent through the Polish Red Cross, a government-controlled agency separate from the International Red Cross, is ending up in government hands.

Individual gift parcels from the West are being confiscated at the post office for several reasons. Lack of a "clearly defined" address is one frequently used excuse. If the addressee cannot be identifed, or if there is an error in the address, the parcels can be handed over to the ministry of health and social welfare. The ministry passes them on to "the sections of the population most in need of such gifts," according to official statements. Perishable goods are sold at market prices and the proceeds are set aside for undefined "social aid."

Parcels mailed to internees are confiscated if they contain any "prohibited foodstuffs," but it is impossible for relatives abroad to obtain a list of what is and is not allowed. They only know that chocolate is forbidden.

A directive by the post office last week told sorters to "remove from the post" any relief parcels with "provocative" slogans and stickers on the outside.

Some relief organizations try to send their own representatives with their consignments. In these cases, Polish consulates have been instructed to propose a bargain: They will give a visa to the representative if a "reasonable proportion" of the gifts, say 30 percent, is handed over to the state. The consulates are then permitted to let the organization bargain with them. Some naive groups have glowingly reported back to their members that they got away with handing over "only" 10 percent of the consignment. Some Polish consulates find this task distasteful and usually give visas when the charity organizations refuse to negotiate.

There are also perils on the road to Poland: West Germans visiting East Germany report that oranges have suddenly appeared on the black market in East Berlin and Leipzig. They believe East German border guards have "confiscated" the oranges from Poland-bound convoys and then quietly disposed of them to their own advantage.

Mr. GLEASON. I am part of the international labor movement and belong to the ITF, and we have tried to convince our European counterparts, especially in the common market, that they should take the same kind of action we did, because this is their one opportunity. If that Eastern bloc is going to fall apart, it is right now.

Going back to OPEC days in 1973, the Russians were behind that move of raising those prices because they were outside of Saudi Arabia and they were the largest sellers of oil around the world. And now with building the gas pipeline there, and us OKing it and giving them credit with the help of our own people, they are going to make $10 billion.

Senator KASTEN. Hard currency dollars.

Mr. GLEASON. Hard currency dollars. What is going to happen, especially in the Middle East, and this is going to be the trouble in the Middle East because there is going to be trouble in there because there will be very little shipments coming with the exceptance of Saudi Arabia where we buy most of the oil. But out of Kuwait and the rest of

those countries you are going to see a collapse in those countries because their economy is built up, and they invested a lot of money in building and in other areas, and they are going to collapse because of a shortage of money, a shortage of American dollars.

I have been reading recently that it is so bad in Russia that they had to sell 300 tons of gold to get the hard currency to pay off some of their debts.

Senator KASTEN. They are selling diamonds also.

Mr. Kahn, do you have any specific statements on the number of people that were detained and who they were?

Mr. KAHN. We have maintained contact with groups of Solidarity activists in Europe and here who happened to be out of the country at the time that martial law was imposed, and they have contacts with Solidarity in Poland.

All of the people that I have talked to believe that the numbers of detainees given by the Polish government are much too small. The lowest figure I have heard from Solidarity activists is 10,000 and from some people I have heard figures several times that, but no one believes the figures the Polish government gives out which are inconsistent among themselves.

They also mentioned on the question of default that the policy has always been from the very beginning of the creation of Solidarity that we would favor those policies and undertake those actions which Solidarity wanted. Again, almost all of the Solidarity people we talked to, including those who have contacts inside the country, favor calling in the Polish debt and are opposed to the extension of further credits to Poland and to the rest of the Eastern bloc.

So in that sense we feel that we are representing the interests of Solidarity.

Senator KASTEN. I absolutely agree with you. We have had testimony from people, including a former Polish Ambassador, and it is just overwhelming the support for calling in the debt. Of course, there is a case right now.

I maintain that using the taxpayer dollars that are intended to go to farmers, including farmers in Wisconsin, through the CCC, is illegal anyway, it is against the law. The law says that you cannot use those taxpayer dollars, the CCC dollars, to bail out either interest or principal payments unless those debts are declared in default, and those debts have not been declared in default.

I have a couple of other questions, but at this time I would like to yield to Senator D'Amato, the Senator from New York, who shares our great interest in this particular issue.

Senator D'AMATO. Thank you very much, Mr. Chairman.

I would like to commend Mr. Gleason for his statement and for his firm position not only now but over the years in regard to deprivation of human rights and the basic overall manner in which I think this Nation repeatedly has failed to meet the aggressive actions of the Soviet Union and/or its client states acting either directly or as the agent for the Soviet Union.

There has been a suppression of the Polish people by General Jaruzelski, a carefully, very coordinated suppression which the Russians were active in planning and seeing to it that it was carried out with great dispatch and efficiency. Make no mistake about it, General Jaruzelski did not move in that manner to save the Polish people from a blood bath but rather to do the bidding of the Russians in the way they could not do themselves.

In addition to the question of the Polish debt, it seems to me, and your statement touched on it, that there is an opportunity for the United States and allies to use its economic strength, that which we still retain, in marshalling our forces collectively, even if we have to agree privately with our allies to hold them harmless for the losses that would be incurred, in a cessation of the building of the gas pipeline, which in my way of thinking will be a grievous blow to Western Europe and to the United States for many, many reasons.

I have indicated to Secretary Haig that it appears to me and obviously to the Russians who have been used to hearing our rhetoric that empty rhetoric will do very little to change the attitudes and to change the course of action and conduct of the Russians.

But if our allies were to come together for a perod of time, 6 months, 9 months, or 1 year, that over that period of time that we would see a marked change in attitude from the Russians, we would see Lech Walesa released and we would see a move to restore and to move in a direction to accommodate our requests and legitimate interests.

But we fail to do that. We take the easy way out. We would rather talk about that it would cost the West Germans $400 million and it would cost the British $1 billion and it would cost the others, and I find it inconceivable that we are directly or indirectly allowing the subsidization of that pipeline at interest rates that are below 8 percent, extending credits, and that we sit by and countenance it although we have these strong words.

So I am just here to say to you that I think that your approach and that of organized labor is much more correct than that which I see as rhetorical, which never answers the questions, which makes grandiose statements and flys in the face of I think a great statesman and a great President who said "Speak softly but carry a big stick," Teddy Roosevelt.

We make great pronouncements but fail to back them up. Consequently by our own acts, or at least our rhetoric, I believe we set the climate repeatedly and in repeated areas of the world whereby the United States in its statements, those put out by Secretary Haig, don't mean much because after all they have been saying it for years, and not only this administration but the previous administration.

So we may even entrap and enduce other nations, the Russians included and their minions to undertake a course of conduct predicated only upon the U.S. unwillingness to face some of the hard decisions.

You know, the price of freedom is something that has to be paid for by all. When we have the economic interests of our allies that are continually put forth as reasons for us not taking what the proper course of

action is, then history will repeat itself. I suggest that happened prior to World War II when there were those accommodations that we sought repeatedly with Hitler. You don't deal with these kinds of totalitarian states by merely putting out rhetoric.

So I commend you for your very forthright position.

Mr. GLEASON. Thank you very much.

While you were talking I was thinking about these fellows. We have been mixed up in this business since 1956. In 1956 with the Egyptian/Israeli war we then took our position then with the Israelis against them and we went over there. In the Nigerian war we took our position there. In fact, I was sent down there and worked those docks down there after that trouble was over with down in Laos. I was in Vietnam in 1965 and 1967 with loading ships and unloading the ships over there in the Port of Saigon and Cam Ranh Bay. I saw what was happening with these Russians.

My learning was very short. I have been working since I was 15 years of age on the docks. If I live till August 15 I will have 67 years in there. Being near 82 years of age I have been watching these guys for a long time. I watched them when Litmannaut [sic] came over here in 1934 when he brought all his infiltrators over here and tried to take charge of the transportation unions. He tried to take over this country. I watched it and the fights that led up to CIO being formed in 1937, and then much of that trouble was adjudicated in 1955 when George Meany put them together.

But what I have been watching lately has been this. A fellow by the name of Robert Morse wrote a book and a story about them building an underground city in Russia at least 5 miles long and storing food and getting ready in case there is a nuclear war. And we are doing nothing about it. All we are doing is giving them credit.

We are giving them the credit to buy all this military stuff and then they can use their own money for their bread and butter over there. But we are giving them money to build up their military machine and it is the greatest military machine the world has ever seen.

When the hostages were taken in 1979 in Iran we tied up the Iranian ships and didn't work them and we haven't been working them since and they are now suing us for $1.5 million. They are about No. 10 in line to get our money. You know, when we had no money nobody was suing us. Now you have got a few shillings in the bank and they want to sue you.

But these are the things that we have been working on since 1956. We have a group of men. We couldn't do this alone. We don't do this alone. Unless we had the help of 116,000 men around the United States to do this job, and when they call us and say we should do this, we take charge of it so that we have charge and control of it. There is no question at all about it. All they want to know now when we say something about a boycott is what ships do we work. But this is the kind of a union the ILA is. And, my friend, Mr. Chairman, the bankers call me every once in a while and I grin, you know, and I told Mr. Secretary of State the other day I am like Delta, I am ready when you are, if you

have to do it. The Longshoremen have a long experience and we enjoy what we are doing anyhow.

Senator D'AMATO. I would like to commend the chairman for his courage in moving forward in an area that very few have ventured forward in and there is a very formidable array of opinion within and without the administration that takes a contrary point of view. It is always easy to get on a ship or a vehicle that everyone is behind and pushing, but it is a different matter to steer an independent course in turbulent times. So I commend the chairman and my colleague for his distinguished leadership in this area.

Senator KASTEN. I thank the Senator from New York.

Mr. Gleason, yesterday's Washington Post reported that according to a confidential Polish Communist party document circulated in Warsaw the Polish military regime has three possible strategies for dealing with Solidarity. Their first possible strategy was to reinstate the union under new leadership, the second was to form two separate Solidarity unions, and the third was to disband the movement altogether.

Are any of these options acceptable to you or to the AFL–CIO or to the Solidarity leaders now based in Paris and in Stockholm with whom I know you and the AFL–CIO have been in close contact?

Mr. GLEASON. Oh, I think that the position of the AFL–CIO and Mr. Kirkland is that we are supporting Lech Walesa and his colleagues all the way down the line. This is the position we took when we issued the statement, that we were going to support them until martial law was lifted. That is still his position. He is the head of the AFL and we go along with whatever he does. That is his position. He is going to support Solidarity all the way.

Senator KASTEN. So you would reject any of the three options that were circulated in this confidential Polish communist party document?

Mr. GLEASON. The Russians, we underrate them. They subscribe to every piece of literature we print, newpapers, books and magazines, and they know what we are doing every single day. They try to get our position and then try to match the position which is going to benefit them a little bit and make it look like their position altogether.

I think if we listen to the Russians and take any advice off of them we are absolute fools at this particular time. I think what we have to do is support Solidarity all the way or we lose our credibility.

Mr. KAHN. If I might, Mr. Chairman.

Senator KASTEN. Absolutely.

Mr. KAHN. It is the view of the AFL–CIO that no government has the right to determine the shape and character of a trade union movement which is a voluntary association of workers which should be controlled and run by workers.

There are other countries in the world in which governments attempt to shape and regulate the trade unions, and we are opposed to that practice elsewhere as well.

It seems to me that there is no solution to the Polish problem. There is no possibility of a new trade union movement to be formed that does not include Lech Walesa.

The key question here is, Why has the Polish government kept him under wraps for 3 months and kept him incommunicado, spread rumors repeatedly that negotiations were underway or about to commence, and there is a new round of such rumors today, rumors that he might accept this or that arrangement? Why not let him speak for himself? Why doesn't the Polish government put Lech Walesa on television to say what he thinks ought to be done?

The character of the Polish trade union movement should be determined by the workers of Poland and by the leadership chosen by the workers. That means that Lech Walesa has to be released. We would oppose all solutions that are proposed by the Polish government that are not acceptable to Lech Walesa and the workers of Poland.

By the way, there are not only three possible solutions. There are probably four, five, or six. The Soviets have a lot of experience in infiltrating, subverting and undermining free trade union movements. They actually have more experience doing that than they have directly invading other countries, and there may be other possible formulas.

But just as we don't believe we ought to tell Solidarity what form it should take and what its goals and policies should be, we also don't think the Polish government should do that. That is up to the Polish workers.

Senator KASTEN. Mr. Gleason, several Polish experts have testified before this committee that the Soviet Union faces a complete collapse of the Polish economy within a year. You suggested the bankruptcy of the Soviet system and the Eastern bloc countries when you were talking about the sale of gold and the other actions that they were forced to take. We have had people say that the Polish economy just isn't going to make it.

The Soviets would then have three options basically.

The first is to bail out the Polish economy using Soviet resources which would have the indirect effect of forcing them to spend less on their military and more on the infrastructure in Poland.

The second choice that they might have in the Soviet Union would be to consider the Polish economy a total loss and with the outbursts which would result and that would result in a direct invasion.

The third, and probably most likely, I am afraid, is that they would work to gain more Western credits by giving the appearance of liberalization. By letting some people go, by giving the appearance of letting up some way and then saying the economy is collapsing they will want to start to open the pipeline once more.

I am afraid, frankly, that we are beginning to see this kind of deception right this minute on the part of the Polish government, an appearance of liberalization without liberalization. I think we can see that beginning.

Now isn't the real danger that we will be hoodwinked again and American and German banks in particular will push for more loans to Poland in order to protect the loans that are already made? Do you see this as a possible difficulty that we should be prepared to deal with?

Mr. GLEASON. I think you have got to be prepared to deal with it and maybe so. You have got folks like David Rockefeller there who swing a big stick themselves, you understand. But if we ever give up now, if we ever lose this opportunity to take advantage of what is facing us now as far as Russia is concerned, let them collapse, cut off all credit to all the Eastern bloc altogether and let them collapse, and then let us take advantage of what we can do to free human beings and give them a sense of dignity and a sense of something that is decent. No more credit to Russia and no more credit to any of the satellites. That is all. I think this is the opportunity we have.

I was reading this morning in the paper about selling more gold. Let them sell all the gold they got. It will bring the price of gold down here and we will all be buying gold. It will be back at $32 an ounce again. Let them sell it.

I think we have an opportunity now to take advantage, and the first one is Poland, and you have Romania, you have Yugloslavia, and some of the others are in the same shape.

Senator KASTEN. I don't want to keep you because we have other witnesses, but one of the questions that came up with this scenario of a complete collapse of the Polish economy was what kind of hardships do you believe that that would create for the Polish people? Do you think there would be a backlash on behalf of the Polish people, including the Solidarity Union members and sympathizers, that they would think the United States of America has abandoned them and now they are just in complete economic collapse?

Mr. GLEASON. Well, I think there is a chance of that. There is always a chance of something like that happening. But I don't believe that. I think the Polish people know, and especially from the church there. Poland would have been invaded a long time ago if it wasn't for the church and Pope Paul and the strength that he has there. I don't think there would be any backlash. If that time came when the Russians pulled out and let Poland collapse, then we should step in and try to help and show the people that we want to help in that country and bring about a good government there.

Senator KASTEN. You may know by reviewing the testimony, but I asked that same question to several Polish people, people with Solidarity or whatever, and they were unanimous in saying, "No, the Polish people would not blame us," and that in fact the Polish people are almost in turmoil right now and they are willing to go through almost anything.

Mr. GLEASON. I have at least 350 to 400 letters, and maybe more than that. If you saw these letters condemning me about the foodstuffs, and they want to get those foodstuffs over, and they don't want any part of the Polish government at all. They criticize the ILA as being something similar to Hitler. They say at least Hitler let the packages of food go through to the Jewish people and we were denying the packages going through.

But I think the church over there, and we are in touch. I happen to be a Catholic, and I happen to be in touch with some people. In fact,

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we are in touch everyday with all the European leaders of dockworkers around the world who are trying to get everything set for the day that we have to do it. We are trying to force them to do the things now. We haven't tied the Polish ships up for one reason. We just tie the Polish cargo up. The ships come in and we are trying to convince the sailors to jump, to this effect, and we are successful in 14 to 15 instances already, and we are trying to do this.

They see what kind of conditions we have here and they are getting the mail back home because we are sending the mail back. I don't know what they do with it when it gets over there, but we have never stopped the mail from going over. I presume it is going by American planes anyhow. But we are in touch with everybody, and the dockworkers around the free world are trying to get a uniform policy here because I think the labor leaders are the only ones that are going to convince the West Germans because Chancellor Schmidt has trouble with Willy Brandt. He was infiltrated, you know. It happened to Willy Brandt. The Dutch are the same way. The Belgiums are the same way. The French, I don't have to tell you about Mitterrand. But we are in touch everyday to see what we can do to help to unify the action against Russia in Poland.

Senator KASTEN. Mr. Gleason and Mr. Kahn, thank you very much for your strong testimony here this afternoon. I just want to say on behalf of the committee that we look forward to working with you, but we very much appreciate you being here.

Mr. GLEASON. Thank you.

Mr. KAHN. Thank you.

Senator KASTEN. The next witness is the Hon. R. T. Davies, the former U.S. Ambassador to Poland.

Mr. Davies.

FORMER U.S. AMBASSADOR TO POLAND

STATEMENT OF HON. R. T. DAVIES

Ambassador DAVIES. Mr. Chairman, I have a brief prepared statement which I would like to read.

As I understand it, the question is should the U.S. Government require banks that apply for payment of overdue Polish government debts to declare the debtor government in default before it acts upon their applications for payment?

The answer seems to me to depend upon the intentions of the U.S. Government and whether it plans to take the further steps that the President and the Secretary of State earlier said would be taken if the situation in Poland did not improve.

I heard Mr. Gleason refer to some of those statements made by the President and the Secretary of State.

The situation in Poland has not improved. Martial law remains in effect, the imprisoned Polish trade union leaders have not been released and, despite recurrent stories planted in the Western press about impending talks, negotiations with the leadership of Solidarity have not resumed.

On March 8, the Polish government spokesman, Jerzy Urban, announced that trials were being prepared against about 100 of the Solidarity activists arrested on December 13, 1981. He made this announcement despite the statement of General Jaruzelski proclaiming the imposition of martial law in which amnesty was promised for activities which took place before December 13. Priests have been arrested. The Polish government continues to enforce the state of war against the Polish people.

On January 19 at a press conference President Reagan said, "We're not going to wait forever for improvement in the situation" in Poland before consideration will be given to other things "that can add to the steps that we've already taken."

Both the President and Secretary of State Haig have said a number of times that we would not do business as usual with the Soviets and the Polish regime. In his nationwide television address on December 23 the President said, "I want to state emphatically that if the outrages in Poland do not cease we cannot and will not conduct business as usual with the perpetrators and those who aid and abet them. Make no mistake, their crime will cost them dearly in their future dealings with America and free people everywhere."

But, Mr. Chairman, we are still doing business as usual with both the Soviets and the Polish regime in important areas of commercial and financial relations.

The United States is still doing business as usual with the Soviets by selling them massive quantities of grain thus relieving the pressure on the Soviet leaders to make necessary reforms in their agricultural economy.

Clearly, it was the signal sent by the President to the Soviet leadership in April 1981 when he lifted the partial grain embargo that President Carter had imposed. It was this signal indicating that President Reagan valued the profits from grain sales more than he did a peaceable resolution of the unsettled Polish crisis that led the Soviet leadership to conclude that it and its Polish proteges could do away with the imposition of martial law.

Our West European allies are still doing business as usual with the Soviets by financing the Urengoy pipeline on very favorable terms, much more favorable terms than their own citizens can obtain when they seek to borrow. I forebear to mention the still less favorable terms at which U.S. citizens are forced to obtain loans.

American banks are still doing business as usual by avoiding declaring Poland in default, and the U.S. Government is assisting those banks by paying off Polish debts for them.

Now Under Secretary of State Buckley is in Europe holding discussions with our NATO allies about the future of sanctions.

Even before Under Secretary Buckley left on his trip, however, Secretary of Defense Weinberger appeared to have given up on the effort to convince the West Europeans to reconsider their position on the pipeline, although the removal of just one American division from Western Germany, a move which is long overdue on other grounds in

any case, would focus the attention of the Government of the Federal Republic as effectively as being hit over the head with a 2-by-4 is said to focus that of a Missouri mule.

In this, as in other instances, the Reagan administration appears to be long on threats and short on the kind of actions which are an essential ingredient of leadership.

Is it not likely, therefore, that Under Secretary Buckley will return from his trip convinced that there is nothing we can do to stop our West European allies from proceeding with the Urengoy pipeline and that, in addition to permitting Caterpillar to sell the pipelaying machines to the Soviet Union, we should go ahead and permit General Electric to supply the rotors for the turbines?

If that is to be the outcome of the current wavering in the administration's position, then I should strongly support requiring our Government to make the banks declare Poland in default before making any more guaranteed payments.

The requirement that banks hold Commodity Credit Corporation credit guarantees declare Poland in default before they could collect overdue payments from the U.S. Government would, under the circumstances I have outlined, be a measure of desperation signaling that all U.S. efforts to achieve the imposition of meaningful sanctions were at an end. It is unlikely that banks in this country not involved in loans carrying CCC credit guarantees, banks in Western Europe or Japan or official lenders outside of the United States would follow our lead. The U.S. Government would thus stand isolated on this issue.

The President has said that the action of the U.S. Government in repaying overdue Polish government loans backed by CCC credit guarantees resulted in giving the U.S. Government increased leverage vis-a-vis the Polish regime. So far, however, the U.S. Government has not used that leverage.

In my view, it would be preferable now not to require that the banks declare Poland in default, but to use the leverage implicit in the threat of the imposition of such a requirement in an effort to impose meaningful sanctions on both the Soviet and Polish governments instead of the purely symbolic ones now in effect.

If the President is not just bluffing again, but really means to do what he said he would, that is, to stop conducting business as usual with the Soviet and Polish governments and to make their crime cost them dearly in their future dealings with America and free people everywhere, he should, in my view, first, embargo all U.S. exports to the U.S.S.R., including grain and phosphates, as well as the Caterpillar pipelayers and the General Electric rotors, or rotors made elsewhere on General Electric license and, second, convoke parallel conferences of the creditor governments and creditor banks.

The purpose of these conferences would be to forestall the precipitation of default by offering the Polish regime the following deal.

If the Polish Communist authorities would, first, lift martial law immediately, second, release all political prisoners and detainees, third, revoke all decrees and regulations issued by the martial law regime and,

fourth, sit down again with the Presidium of the Independent Self-governing Trade Union, Solidarity, and its advisers and start to negotiate the social contract which by the signatures of its Deputy Prime Ministers, Ministers, and Vice Ministers to more than 700 agreements with Inter-enterprise Strike Committees during August and September 1980, the Polish government obligated itself to conclude, then the Western creditor governments and banks would grant a moratorium on all payments due or about to become due with the proviso that if agreement has not been reached within 3 months the clock which stopped as of the date on which negotiations began would start to run again and the creditor governments and banks would reassemble to consider anew the question of whether Poland was in default.

As soon as agreement was reached between the two Polish parties, that is Solidarity and the Polish government, urgent and sympathetic consideration could be given to Poland's application for membership in the International Monetary Fund and to the establishment of a schedule for the extension of balance-of-payment credits to Poland in installments keyed to the implementation of various provisions of the social contract with Solidarity.

Mr. Chairman, those who know the Polish people know that they cannot be made to work productively at the point of a gun or under the shadow of a tank.

The question the Polish leaders now confront is this, Can they turn the clock back permanently to the conditions of the Stalin period? Eventually they will have to conclude that they cannot. It is possible of course that they will be unable to resolve this dilemma in their own minds in the next few months and that martial law or something by another name with the same content and practical effect will drag on for half a year or a year.

Sooner or later, however, normalization, the Communist code word for re-Stalinization, must give way to the resumption of life under conditions which recognize that Stalin is dead and buried, his political culture of unrestrained terror cannot be revived and a new and fearless generation has been born and grown up in Poland during the past 30 years.

Under these circumstances, the task of the West is to offer a reasonable way out to the Polish leaders. The choice should be theirs. They must choose either to follow the path of the confederates of Targowica, who, in 1792 conspired to betray Poland to the Empress Catherine the II of Russia, or they should choose to try yet again to find the Polish road to socialism.

The policy I suggest places that choice squarely before them in the sight of the entire Polish nation and the world.

Thank you, Mr. Chairman.

Senator KASTEN. Mr. Ambassador, thank you for your statement.

Why is it that you give them this one more chance? In other words, you are suggesting that after Under Secretary Buckley is there and if he is able to come back with a tough, unified position that we are able to cut off the reexports and that we are able to get an agreement, and let

me just paraphrase from your statement: "The policy I suggest places that choice squarely before them in the sight of the entire Polish nation and the world." I would maintain that the choice has been squarely before them in the sight of the entire nation and the world and they have chosen the road of 1792. What makes you think that this next step might be the one that could make a change?

Ambassador DAVIES. Well, Senator, you raise an excellent point. I am not sure that the next step would make the change. I had strongly favored doing this beginning in September 1980. I tried to make that clear to the State Department and the then Carter administration. So this should have been done long since. But the fact of the matter is that we have not imposed any meaningful sanctions on either Poland or, more to the point in my view, on the Soviet Union.

The President has imposed some measures that are designated, that are called sanctions, but I would submit, sir, that they are not really sanctions if you take a look at them. Understandably he suspended new government-to-government credits to the Polish regime. Well, thank goodness, about time—16 months late, but he did finally suspend them.

He cancelled Polish fishing rights in American waters. That was a relatively meaningful sanction, but it was meaningful only in terms of cutting off a certain amount of hard currency which the Polish regime was using to pay off their debt because you know they weren't taking any of this fish back to Poland.

He revoked civil air rights for the Polish airline, Wauf [sic], in the United States. Well, that was I think again meaningless.

So out of the three major sanctions that were taken, only the revocation of the fishing rights had any practical effect and it only affected the fiscal position of the Polish government.

With regard to the Soviet Union, he said that high-technology equipment would not be licensed for the Soviet Union, but an exception is being made in the case of the pipelaying machines, contracts for the sale of which had been concluded before his announcement. It looks very much now, although it is difficult to read the administration's position, as though the General Electric rotors are eventually going to be supplied, too. So there will be nothing left of that high technology sanction.

He said the maritime agreement with Moscow would not be renewed, but most of the grain and shipments are being moved in other ships anyway and grain is a fungible quantity as we all know.

That scientific exchanges would not be continued, well, it is a flea bite.

That new negotiations on a grain agreement were being postponed, that of course could be significant if they remain postponed, but I am awaiting with some trepidation today when we learn that Secretary Block is espousing the renewal of negotiations with the Soviet Government for a new grain agreement. I believe that will come before too many more weeks have passed, and that the Soviet airline, Aeroflot would be barred from the United States, again a more or less meaningful step.

So my contention is that we have not really put any sanctions on. The sanctions would be something to do with this fantastic free credit that our West European allies are about to give the Soviets in the form of financing for the Urengoy pipeline and the annual payments which will begin when it is completed in hard currency, and on our side the grain embargo which the West Europeans have made a condition for considering any reconsideration of the Urengoy deal.

Senator KASTEN. I am concerned, and I agree with everything you say, but it seems to me that there is nothing, at least I don't know of anything, that is going to change the position of our allies or change the position of the State Department on the debt issue or some of the other issues that you have brought up, such as the high-technology issue, as a result of the Buckley visit that might be successful.

You said on page 4 of your statement that if we did call the debt into default that the U.S. Government would thus stand isolated on the issue.

Ambassador DAVIES. Yes.

Senator KASTEN. If we did stand isolated on the issue, it would mean that our allies would be reneging on the agreement reached last April among our allies on the so-called tank clause and the so-called rescheduling of the Polish debt. At that time our allies agreed with us that if certain conditions occurred in Poland, we would together call the debt in default and stop this rescheduling and this continual credit policy.

Every single person that has testified before this committee when asked if the conditions of the tank clause have been met, the so-called exceptional circumstances, which is the way it is worded in that treaty, say, "Yes, they have been met by the imposition of martial law and the Soviet proxy government there." If the tank clause has been met, our allies should assume that we are going to call the debt in default, and they should follow us because we have agreed to do that before. We ought not to be isolated on this issue.

Ambassador DAVIES. I quite agree with you, Senator, that we ought not to be isolated and our allies should follow our lead. I remember, however, that after the Soviet invasion of Afghanistan, Chancellor Schmidt of the Federal Republic of Germany said detente cannot stand another such shock.

Well, I don't know how one looks at what has happened in Poland. I would contend that this is a much worse shock in some ways even than the invasion of Afghanistan which was perfectly blatant and open. Of course, here you have an indirect concealed invasion, if you like, in Poland.

So I would hope that you are correct and that our allies would recognize this obligation, but they don't seem to have recognized any of the other obligations I consider that we all undertook, for example, under the Helsinki Final Act which makes provisions for the respect by all the signatories, including the Soviet Union and the Polish government, for certain human rights.

It seems to me that we have every justification to act under the Helsinki Final Act, all of us, but the allies obviously are unwilling to do so. Now are they going to decide that they will reverse their policy on an important matter like the question of whether or not the Soviets are in default? I feel we would be at least justified in raising a very large question mark about whether they would follow our lead.

Senator KASTEN. I believe, Mr. Ambassador, that if our NATO allies want to continue to renege on these various agreements, so be it, but we ought to force them to that position and either they renege or they go along with the agreements. At this point we are kind of in a limbo in which we really haven't presented them with that choice.

Ambassador DAVIES. I agree.

Senator KASTEN. As you know, there is widespread bipartisan, bicameral support for such things as the so-called Mansfield amendment and other efforts toward Europe. It is based on the fact that they are reneging on too many of the basic ideas. At one point or another we have got to recognize reality rather than all this rhetoric. So I think that they ought to expect that we would act. They agreed to act, and I think we ought not to be isolated.

Ambassador DAVIES. I would hope that we would act, Senator.

Senator KASTEN. Earlier I told Mr. Gleason that I am afraid that we are beginning to see a trend of deception on the part of the Polish government and an appearance of liberalization without real liberalization. I suggested to him that the real danger might be that we could be hoodwinked once more, and that somehow the banks will be pushing for more loans into Poland in order to protect the loans that we have already made.

Could you comment? I am interested in your view of this as one with a good deal of experience. Do you think we are in the process of seeing an effort at an appearance of liberalization without liberalization? I would like for you to comment on that.

Ambassador DAVIES. Yes, I think that is exactly what they are doing. I think it was Mr. Kahn who referred to these constant efforts to portray the situation in such a way as to lead people in the West to believe that negotiations are still possible between the leadership of Solidarity and the Polish Communist government. I don't believe that any meaningful negotiations will take place or can take place under present circumstances between the Polish communists and the leadership of Solidarity. What they will do instead is precisely what you suggest. They have already made a number of moves in the direction of liberalizing the martial law regime.

At some point I even foresee the possibility that they may simply declare the martial law regime is now over, but most of the contents of that regime will be maintained because there is, so far as I can see, no way by means of which they can permit themselves to let the leaders of Solidarity leave internment or prison without risking an explosion in the country. There may be an explosion in the country even without the release of the leaders of Solidarity. It is quite likely that there will be a spark at some point this spring and idealistic young people who

have been greatly embittered by what has happened will feel that they have no recourse but to use force and there could be, I fear, a bloody result if such events occur.

But I fully agree with you. I think the danger now is that at some point our West European allies who have run interference for the Polish Communist regime rather effectively on a number of occasions here, beginning of course on December 13 itself, will resume that practice and say to us, "Look, they have lifted martial law and now it is time for us to resume business as usual full steam."

Senator KASTEN. Mr. Ambassador, you called the cancellation of the Urengoy pipeline one of the most effective sanctions available to the West in the wake of martial law in Poland. As I am sure you know, Secretary of State Haig has testified that the United States cannot stop construction of the pipeline. At the very most, he says, we can only slow it down, and, frankly, he said that only after my third question on that issue. Then he points out that this small delay may not be worth the rift that would be created within the Western Alliance. In other words, that the result wouldn't be worth all the trouble it would cause, particularly in Germany and with one line of equipment from England. He said that the delay wouldn't be worth the rift.

Now others have stated that the declaration of Polish default would in fact precipitate cutoff of Western credits to the Soviet bloc, a kind of falling out effect, and do more than any high-level talks such as Buckley is about to have or anyone else could do to stop the pipeline. In other words, calling the Polish debt in default would unravel this entire system of credits involved with the Eastern bloc countries and put tremendous pressure particularly on the German banks that are overextended in the Eastern bloc countries already. The result would be that it would have the effect of slowing down or maybe even stopping the pipelin

Do you believe that we can, in fact, stop the construction of the pipeline? Then, last, how can we best bring that about?

Ambassador DAVIES. Well, I think we could stop construction of the pipeline if we showed that we were prepared to call into question the existence of the Alliance. The question is what this Alliance means? What is it for? It is supposed to be for the defense of Western Europe, and of course we have a strong interest in defending Western Europe.

In fact, however, the governments of Western Europe, principally the Government of the Federal German Republic and the French Government as well, and some of the smaller governments, too, are dealing with the Soviet Union on such a scale, offering credits to the Soviet Union on such a scale that not only are they, to my way of thinking, exploiting the United States in this regard.

You know, they are lending, as Mr. Gleason very correctly said, the Soviets moneys or giving them resources which they can use to replace their own resources that would have to go into building up their armed forces. So we are making it possible for those governments, at least for the Soviet Government and other governments in Eastern Europe, to have both guns and butter.

We see what happens when the people of one of these countries is deprived of butter. We have seen that graphically I think in Poland since 1976 when all this really began. So understandably the Soviets are very reluctant to see a diminution in the supply of butter to their own people, and they have shown signs of that already this past year.

I think that they have become so dependent now for the really scarce resource that they need, that is capital, on the West that they would be given very serious pause if this capital were to be cut off.

Now, I confess, Senator, it is impossible for me to envisage a situation in which our compelling some banks here which hold CCC credit guarantees to declare Poland in default would result in a situation which would bring down the whole house of cards. It seems to me, I am afraid, there are too many people interested in keeping that house of cards from crumbling.

You refer to our allies in Western Europe. There is an enormous interest there, and it is not only they who are interested. There are many people in this country who are interested. First of all, our own bankers who are involved in loans to Poland. Second, we have the great grain brokerage houses which are skimming the cream off the grain trade. They will be very interested and they have a great deal of political clout as well. Finally, there are, I should say, a certain number of American businessmen and others, farmers, who are interested in the trade.

So I am just wondering now would the mere fact that a certain number of American banks have to declare a default be followed by these other banks in Western Europe. Would it be followed by the West European governments who are the guarantors of so much of the debt? Would they follow our lead?

If I could feel sure that they would, that would I think change my attitude toward the answer I have given here. I would then feel that it would make a lot more sense to go ahead and do this. But I am simply not convinced that they would do that. I am afraid that we would end up, having done that, more or less isolated on the issue. You have got so many interests against doing that.

The only way I think we can affect this situation is, first of all, to show that we ourselves are prepared to sacrifice by putting on the grain embargo, second, by telling the West European governments and bankers if you don't agree with us on a unified credit policy toward the Soviet Union and Eastern Europe, then we are going to have to go ahead and ask our banks to declare Poland in default. I think this threat might be useful vis-a-vis then.

Senator KASTEN. You are mixing two issues here. I don't want to take much more of your time since we have another witness, but I don't want to get involved as much in the trade issue. I want to separate the two issues. There is a cross-default clause in these loans.

Ambassador DAVIES. Yes.

Senator KASTEN. I hope that you are not disagreeing with me when I say that by declaring the U.S. loans in default it would put on great pressure, and it is most likely that the result would be that the five German banks that are affected would end up by having their loans in default as well.

The fact is that there are German banks that are dangerously extended in terms of credits to the Soviet Union and those particular German banks want the pipeline finished because as soon as that pipeline is finished they will start seeing hard currency with which the Soviet Union can pay back the loans.

Now through the cross-default clause, it seems to me, if we declare the debt in default, that puts those German banks in chaos, and it means that they are going to have to do some very, very serious thinking as they extend the credit to the Soviet Union in the immediate future. Do you agree with my description?

Ambassador DAVIES. Certainly, Senator, this would create a real problem for them. There is no doubt about that. My only question is whether there would be this kind of automatic cause-and-effect reaction. It does seem to me that the interests that are involved are so large and powerful, including whole governments, and we have already seen in the case of our own Government how certain regulations or rules, precedents, call them what you will, can be changed at the last moment.

Senator KASTEN. In my opinion, illegally.

Ambassador DAVIES. I couldn't agree more. I am simply afraid that with the amount of what is at stake here in Western Europe that they would find some way to get around to water down or to avoid the full impact of the effect of the application of a cross-default clause. I am afraid of that. Then I think other things would begin to crumble as well, and not just the credit house of cards, which I would like to see crumble enormously and I wish we would do something about it, but also there would be important political effects felt, as you intimated earlier, within the Alliance. I would hate to see that happen.

It does seem to me that one reason we ought to pursue the course I have tried to outline here would be that it does give us, you are quite right, kind of a last chance to see whether we can't work out something inside the Alliance before finally we dust our hands and say well, the heck with it.

Senator KASTEN. I have discussed this issue at length with Mr. Hormats, Mr. Buckley, Mr. Leland and with a number of other people who are involved in this whole process, and we will see what they come up with.

Ambassador DAVIES. Very good.

Senator KASTEN. Frankly, I am nowhere near as optimistic as you are. I think the only positive thing about these negotiations is that we should have a pretty good idea of where they are going relatively quickly. The issues have been before us for so long that nobody is coming out with any new ideas or any new agreements. They have been sitting there, and we stewed over it for 3 or 4 weeks here. They should have been over there and back by now.

Ambassador DAVIES. I couldn't agree more.

Senator KASTEN. We went through a whole lot of domestic political considerations and some national security considerations before we even allowed the Buckley mission to go, and they were scheduled to go, as you know, in January and the whole thing has been delayed.

Ambassador DAVIES. Yes, I know. But I do think it is worth thinking about, at least in passing, the political game that is going on here. You referred in a question to Mr. Gleason, to the question of the attitude of the Polish people if their government were able with greater credibility than it now can to blame us for the difficult times through which they are going. I can foresee almost no conditions under which the Polish people can blame us. I quite agree with the answer that you received from this side of the table.

But it does seem to me that we should do what we can to put the blame where it ought to rest, and that is with the Communists. We should really put the finger on them and say, look, you have a chance, a last chance, if you like. We should not give them carte blanche. It should not be open ended and there should be definite time periods involved. And if you don't meet the objective within that time period, then we have to go ahead.

But it does seem to me that there is still some possibility, however faint it may be, of convincing not only the Polish leaders, because they after all are not the crucial element, it is the Soviet leadership, that it is in their interests to permit an outcome in Poland which is different than the one we now have.

Senator KASTEN. Mr. Ambassador, I thank you for your statement, for your testimony and for your participation in these hearings. It has been very, very helpful.

Ambassador DAVIES. Thank you.

Senator KASTEN. Our next witness is Dr. Jan Vanous, senior economist, Centrally Planned Economies Service, Wharton Econometric Forecasting Associates, Inc.

I have before me a series of statements. It is my hope that we could make all of this material a part of the record and that you could in one way or another summarize this material and then possibly respond to some questions by the committee.

Dr. Vanous.

WHARTON ECONOMETRIC FORECASTING ASSOCIATES, INC.

STATEMENT OF JAN VANOUS, SENIOR ECONOMIST, WHARTON ECONOMETRIC FORECASTING ASSOCIATES, INC.

Dr. VANOUS. Thank you for the opportunity of being able to testify.

I will concentrate on one of the analyses that we supplied, and that is on the potential impact of declaring the Polish debt in default, which I think is the most serious issue facing this committee.

We do not want to make a policy recommendation. Rather, what I would like to discuss is what we believe might be the implications of taking such a step which is something that not many people are discussing.

In particular, by declaring the Polish debt in default there would be several regions of the world that would be affected. First of all, it would be Poland itself, then the Soviet Union and the rest of Eastern Europe, the United States of course, all the rest of the European allies, and, finally, less developed countries.

As far as the impact on Poland, we believe that by declaring default this may not in fact be nearly as disastrous for Poland as is generally believed. In fact, we could visualize that from the purely Polish point of view it may be one of the best things that could happen to them.

Right now they are burdened with a $25 billion debt, of which about $20 billion is owed to the developed West. The interest cost alone of that debt runs between $2.5 and $3 billion.

If Poland was not required, or there was no point in repaying any of that debt and it did not have to pay the interest, its external accounts would basically be balanced.

Senator KASTEN. Could I interrupt you right here, because you are making an assumption that I want clarified. You are assuming that a country going into default would be treated in the same way that an individual going through individual bankruptcy is. In other words, somehow after the country has gone into default that the debts and the obligations are no longer owed.

We have had one instance, and it is hard to define, when the Sudan went into a default period. But we don't honestly know the effect, and there is no such thing that I have been able to find as a set of laws and rules on how a country goes into default, and what the rules and responsibilities and the rights of its creditors are.

So I don't want for you to begin your argument by assuming that they can somehow walk away from those debts because I don't think that is clear.

Dr. VANOUS. Really I am trying to visualize being in Polish shoes right now. If I were a Polish decisionmaker, what is it that I would do? Well, I feel certainly if I am declared in default or if the country is declared in default, it is not in my interests to service any of my obligations until such time as we get to a negotiating table and begin to ask questions of what are we going to do now? We are bankrupt. Are we going to work out a repayment schedule or something?

In the meantime, there is no point of course in paying anybody because that would be like throwing money away. We could use that money more usefully to buy various goods and services.

It has been said that by declaring Poland in default that one of the first things that would happen is that Poland's western creditors would attempt to seize its assets and it would greatly disrupt the country which would naturally put the government under serious pressure. The assets that could be seized are very small and there is some question of what the cost effectiveness of such a procedure would be since there are not many Polish assets abroad.

Second, we believe that Poland would still be able to conduct a good deal of its foreign trade, even under default, basically on the basis of cash transactions.

If we exclude the obligations that they currently have to repay some of the existing debt and service it in terms of paying interest, then Polish trade is already balanced. So as long as they were able to find some trade partners who are continuing to deal with the on cash transactions they could conduct trade. Naturally there are quite a few coun-

tries that could conduct trade with Poland under such circumstances. I believe countries like Sweden, Finland, Switzerland, and Austria would continue conducting trade with Poland so long as they get paid in cash.

Also, there are some procedures that a country could take in order to prevent its goods from being seized, which is another way the Poles would have to prevent foreigners from trying to seize its exports to satisfy claims against it. We believe that that could be set up relatively easily, for example, by having all Polish foreign trade corporations taken over by East German corporations.

All it would take is to put an East German official into each one of the Polish corporations and nominally make it an East German corporation and you could continue trading as if you were an East German corporation out of Poland. There is very little that the Western creditors or governments could do. So we feel that Poland may not even suffer a significant decline in her trade with the West.

On the other hand, by declaring default on Poland, we believe that the Soviet Union and the rest of Europe would indeed be seriously affected.

First of all, Eastern Europe would be affected, and Eastern Europe is already affected in the sense that the nervousness of Western bankers about the situation in Poland and Romania has made them unwilling to roll over existing credits or issue any new loans.

In fact, what we are seeing is that some of the East European countries are reducing their debt exposure absolutely, because as some of the debts come due they have to repay them and they are not able to raise the new funds. For example, Hungary, Yugoslavia, and East Germany, banking officials have clearly stated that they are having serious difficulties raising any credits.

We tried to visualize what would happen if indeed the West was able to cut off any new lending and in a sense we would have a situation where no new credits are being issued and the Eastern bloc is being forced to repay some of these obligations.

We feel that in a situation of such credit squeeze that in a matter of 12 to 18 months some of the other East European countries would be in such serious trouble that they would have no choice but to ask for rescheduling. Of course, Romania has already done so. The next country probably that would be in serious trouble would be Hungary followed perhaps by Yugoslavia. Bulgaria and Czechoslovakia are not as vulnerable.

There was some question as to what degree these countries could expect Soviet aid. In this analysis that we prepared we did not visualize the serious deterioration in the Soviet external earnings that is taking place right now, because, of course, a few months ago nobody was expecting $28 to $30 oil. Now it is becoming increasingly certain that world market prices for crude oil are falling to such a level that this will mean a serious deterioration in Soviet external earnings, which in turn will make it more difficult for the Soviets to aid some of the East European countries in trouble.

Senator KASTEN. Let me just understand what you said. In other words, you are using as rough notes here a document that was published February 12, 1982?

Dr. VANOUS. Yes.

Senator KASTEN. And at that time we did not envision the Soviet hard currency problems as they seem to be developing and which are frankly accelerating. So with that are you suggesting that therefore it is less likely today that the Soviet Union would come to the aid of the Polish economy, or are you saying that by coming to the aid of the Polish economy it would cost the Soviet Union even more?

Dr. VANOUS. What I am saying is they would come to the aid of the Polish economy, but they are much less likely to come to the aid of the others. In a sense, there is nothing much left for Hungarians and there is certainly nothing left for Romanians. There will also be an increased limit as to what they would make available to Poland.

Originally we had a feeling that perhaps the Soviets would be willing to make available hard currency credits to Poland, and now it is increasingly likely that, if anything, Soviet aid to Poland will come in the form of credit deliveries of fuels and raw materials on credit rather than actual loans in hard currency which in turn could be used by the Poles to repay some of their obligations in the West.

Also, what is not helping the Soviets currently is the fact that gold market prices are depressed.

Senator KASTEN. In part because they are selling it.

Dr. VANOUS. Certainly that is a major factor, but also the Soviets have rather large import commitments and with an unexpected decline in export revenue they will supplement or they will try to offset some of the export losses by increased gold sales perhaps over and above the level already observed last year where we saw something like 250 tons of gold sold which means perhaps a further decline in gold prices, or we don't see them exceeding the level of $325 an ounce. And there is a limit to how much gold the Soviets can sell of course, too, without really launching the gold market into a very serious depressed level.

So what we see is that the Soviets will probably be less cooperative in terms of helping Eastern Europe; that is, the umbrella is even weaker than thought.

Now I would like to mention a little bit of what we see are the implications for Western Europe. The concern is that banks in several West European countries are very seriously exposed. By declaring the Polish debt in default they would immediately have to write it off which would trigger a major financial crisis in West European countries. West European banks are far more exposed than banks in the United States. There are several banks that would be threatened to the point of collapse. So what would, of course, be required of the West European governments is that they step in and aid some of these commercial banks.

What would happen after the Polish default? If the credit dries up to the point where even existing loans are not rolled over, one country after another may be forced into rescheduling and, in fact, there may be escalation of these debt losses.

The region that we see ultimately most hurt as a result of the Polish default perhaps would be the Third World. Why? We feel that the lesson of Poland will make Western commercial bankers very sensitive to political factors in their lending. By declaring Poland in default the U.S. Government would send a clear signal to commercial banks all over the world that it is willing and can use default as a political weapon to punish countries with which it is unfriendly.

Consequently, there are so many less developed countries with policies that are not necessarily viewed as friendly by the administration that the bankers worldwide would be very hesitant to extend existing loans and issue new ones and we would see a worldwide contraction of commercial lendings to the Third World.

Interestingly enough, one of the countries that is really not a part of the Third World but would be very vulnerable is Yugoslavia. Yugoslavia, unfortunately, lumped together with Eastern Europe and the Soviet Union. Although it is true that Yugoslavia is a Communist country in the sense that it is ruled by the Communist party, it is certainly a country which cannot be considered a part of the Soviet bloc. In fact, that is what we have tried to insure over the past 30 years.

Unfortunately, bankers have begun to treat Yugoslavia as if it were another East European country. Now we feel that the Polish default would certainly put Yugoslavia in such a serious situation that it would bring it also to the brink of bankruptcy and to prevent that we would have to mount massive aid.

Similar aid would have to be mounted up in a number of Third World countries where the United States has strategic interests. You mentioned Sudan, for example. Certainly the lesson of Poland would be felt in countries like Sudan and Zaire and several Latin American countries would be vulnerable as well.

The question is, Is it the objective or does the U.S. Government wish to see these countries defaulting? Sudan is strategically important as a neighbor to Egypt and a neighbor to Libya. Zaire is also strategically important as a neighbor to Angola. We have extensive Latin American interests.

There is also a possibility which is not so unrealistic that some of the West European banks or governments irritated over the default of Poland would retaliate in kind in some of the countries in which we have strategic interests. In fact, to default Sudan would be very easy because Sudan's debt is essentially in default and one European bank could simply declare it in default and trigger through the default clauses and cause other banks to default it as well.

While in principle we don't see a default as a policy that should never be used, we feel that it is an inflexible policy tool because once you use it you have lost it as a tool. We feel that the pressure of the threat to use a default is a far more effective weapon.

At the moment the East European countries and the Soviet Union are already hurting from what has happened in Poland. The Western bankers, contrary to the impression sometimes created, are not making any new loans. They are not even willing to roll over credits, except in the case of the Soviet Union.

Senator KASTEN. That is a very big exception. We had a particularly big exception with the last French loan on the pipeline.

Dr. VANOUS. The reason is that essentially the Soviet Union is viewed as a different class of lender because East European economies are viewed as much greater credit risks because they don't have any resources available really to back up the loans, while the Soviets with their rather large gold reserves and with the mountain of natural resources they sit on they are viewed as a far better credit risk.

So in sense, to get at the Soviets, first, we have to cause very serious trouble in Eastern Europe, and that will have very serious repercussions in Eastern Europe. For example, take the case of Hungary. Hungary feels it is being sort of squeezed in the middle of all this. It is a Communist country. On the other hand, it is a country where serious economic reforms have been attempted. Within the Eastern bloc it is being viewed as an example of what could be done perhaps elsewhere. It is also an example for Poland. Now they feel they are being punished for something they are really not responsible for and they are being pushed back into the Soviet orbit because ultimately when credits from the West are dried up and the country has no where to turn, it will turn to the Soviet Union. It is a question of what it can get from the Soviet Union. It is in a sense a source of aid of last resort.

That is basically it.

[The articles follow:]

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March 12, 1982

THE POTENTIAL IMPACT OF A DECLINE IN OIL PRICES ON SOVIET FOREIGN TRADE IN 1982

The recent trend in world market oil prices must be proving very worrisome to Soviet decisionmakers. During the past two weeks, both Britain and Norway reduced prices for their crude oil from $35 per barrel to $31 per barrel. Iranian crude is selling well below $30 per barrel on the spot market. It is now widely expected that Nigeria will cut the price of its crude by as much as $5 a barrel to regain competitiveness. Prices for the small amount of Soviet crude oil sold on the spot market and, above all, prices for Soviet heating oil have already declined dramatically. This week the representatives of the Finnish state oil company Neste are in Moscow trying to negotiate a cut in the price for Soviet oil delivered to Finland of about $5 per barrel, which would bring the Soviet export price very close to $30 per barrel. Representatives of other West European oil firms can be expected to follow the Finnish example soon.

Some analysts now predict that the prevailing world market price for oil (Arabian light crude) will fall by $4 per barrel and stabilize at around $30 per barrel for the rest of the year. A fall in the price of Soviet oil of $6 per barrel from the 1981 level would mean a major setback for Soviet foreign trade this year. Such a dramatic decline in oil prices would cause difficulties for Soviet planners at any time, but this year its impact is bound to be particularly serious in view of the following:

- At the present time, oil accounts for 42% of Soviet export earnings (excluding gold) in non-socialist countries (55% in the developed West). Total energy exports account for 53% of Soviet export earnings in non-socialist countries (73% in the developed West). Since falling oil prices will exert downward pressure on prices of alternative forms of energy, the Soviets can reasonably expect that prices of one half of their exports to non-socialist countries may decline by 14-17%.
- The prospect for sales of other Soviet exports is not too good either, at least until world interest rates decline and economic recovery in OECD begins to take place. The price of gold is hovering around $325/oz and may decline further if the Soviets increase their gold sales even more. Diamond prices are roughly at one-half of last year's level. Lumber prices have fallen 20-25%. Hence, it would be rather difficult to replace a significant portion of lost revenue from energy exports by increased exports of alternative commodities.
- The series of three unusually bad grain harvests in the Soviet Union during 1979-81 makes it absolutely necessary to sustain the high volume of grain imports, which are expected to reach 40-42 million metric tons this year. While some cuts in imports of foodstuffs and raw materials for food other than grain could be made, there is no room to cut grain imports.
- Continuing detericration in the Polish economy will require continued Soviet aid during 1982, both in the form of deliveries of goods which Poland will not be able to pay for (around 2 billion rubles worth) and hard-currency credits of perhaps as much as $750 million.

- Worsening economic conditions in the rest of Eastern Europe will make it difficult for the Soviet Union to reduce the degree of preferential trade treatment of Eastern Europe or to divert some East European exports from Western markets to the Soviet Union.
- Soviet commitment to West Siberian gas export pipeline construction as well as to other internal pipelines will require a high level of imports of steel products and machinery and equipment and thus take up a major portion of funds available for Western imports.
- Finally, for political reasons, the Soviets may soon experience difficulty in raising new hard-currency credits (other than those related to gas pipeline construction).

In order to assess the potential impact of a decline in oil prices from an assumed average level of $36 per barrel in 1981 to $30 per barrel this year, we have prepared the table presented below. The table contains our preliminary estimate of the pattern of Soviet trade with non-socialist countries in 1981, a "baseline" forecast which assumes an average Soviet export price for oil of $37.50 per barrel in 1982 (which is already $2.50-4.50 below what the Soviet planners in early 1981 were apparently counting on for 1982), and an alternative scenario where oil prices are $30 per barrel in 1982. Our analysis indicates that if oil prices drop to $30 per barrel in 1982 then:

The Potential Impact of a Decline in Oil Prices on Soviet Foreign Trade in 1982
(in billion current dollars)

	Preliminary Wharton Estimate of 1981 Trade	Baseline Forecast for 1982	Scenario with Lower Oil Prices in 1982	Difference Between Baseline and Scenario
Underlying Assumption: Price of a Barrel of Oil in Dollars	36	37.50	30	-
Total Exports to Non-socialist Countries (including gold)	38.2	40.2	34.9	-5.3
Exports to Developed West	23.7	24.2	20.7	-3.5
- Energy	17.2	17.0	13.9	-3.1
- Oil	13.1	12.7	10.2	-2.5
- Gas	3.3	3.5	3.2	-0.3
- Coal, Coke, Electricity	0.8	0.8	0.5	-0.3
- Other Exports	6.5	7.2	6.8	-0.4
Exports to Developing Countries	11.8	13.0	10.2	-2.8
- Energy (all oil)	1.7	1.8	1.4	-0.4
- Arms	6.2	6.7	4.6	-2.1
- Other Exports	3.9	4.5	4.2	-0.3
Gold Sales	2.7	3.0	4.0	1.0

	Preliminary Wharton Estimate of 1981 Trade	Baseline Forecast for 1982	Scenario with Lower Oil Prices in 1982	Difference Between Baseline and Scenario
Imports from Non-socialist Countries	38.9	42.5	37.2	-5.3
- Energy	1.6	1.7	1.4	-0.3
- Machinery and Equipment	7.3	7.5	6.5	-1.0
- Raw Materials	14.0	15.9	13.9	-2.0
- Food (incl grain)	14.4	15.8	14.2	-1.6
- Consumer Goods	1.6	1.6	1.2	-0.4
Balance on Current Account Including Gold Sales	-3.6	-5.0	-5.0	-
- Trade Balance Including Gold Sales	-0.7	-2.3	-2.3	-
- Other Hard-Currency Outlays and Adjustments	-2.9	-2.7	-2.7	-

- Soviet oil export revenue from non-socialist countries would decline from $14.8 billion in 1981 to $11.6 billion--a loss of $3.2 billion, of which $2.5 billion would be due to falling prices and $0.7 billion due to falling quantity of exports.
- Losses in revenue from exports of other types of energy (gas, coal, coke, electricity) could reach $400 million.
- Falling world market oil prices could have a profound impact on Soviet arms sales to LDCs, particularly in the Middle East (Libya, Algeria, Iran, Syria, Iraq). Relative to 1981, these exports could decline by about 25% already in 1982, or $1.6 billion.
- Overall, total Soviet export earnings excluding gold in non-socialist countries would be likely to fall from about $35.5 billion in 1981 to $30.9 billion in 1982--a decline of 13% in nominal terms.
- The above decline in export earnings of $4.6 billion could be partially offset by an additional $1 billion in gold sales. However, total gold sales in 1982 of $4 billion would require selling about 465 metric tons of gold, which is probably the maximum the market would bear without depressing the price further below $325/oz.
- Assuming that the Soviets would not be able to run a current account deficit in excess of $9 billion next year ($5 billion if gold sales are included), Soviet imports would have to be reduced by $5.3 billion from what we project in the baseline case. The cutbacks would probably be fairly evenly distributed, with the largest absolute cutback made in imports of non-food raw materials, followed by food and raw materials for food (other than grain), and machinery and equipment.

A 12.5% decline in the value of imports from the baseline level would probably imply a 20% decline in real imports from non-socialist countries. Such a dramatic reduction would certainly cause a major decline in investment and overall economic growth. In fact, an absolute decline in Soviet GNP in 1982 could not be ruled out because of the multiplier effect of an import cutback. The usual shortages of food and other consumer goods would be accentuated and this would have additional repercussions on economic growth since labor productivity might also decline as a consequence.

March 1, 1982

ROMANIAN EXTERNAL FINANCIAL SITUATION AT THE END OF 1981

In the spring of 1981, a crisis of confidence began to develop in the West with regard to the ability of the Romanian government to handle the country's increasing economic problems without the introduction of a meaningful economic reform. Since then, Romania has been unable to roll over its external financial obligations to Western commercial banks or obtain any significant new credits except for a multi-year financial loan from the IMF amounting to $1.5 billion which was obtained in mid-June (but discontinued in November). This credit squeeze has forced the Romanian government to undertake the following measures in 1981:

- Imports for hard currency, particularly of crude oil from the Middle East, were curtailed--in real terms they declined by 19% (imports of crude oil also fell by 19%).
- Exports for hard currency were boosted 13% in order to close the gap between exports and imports, which amounted to more than $1.5 billion in 1980.
- Hard-currency financial obligations were simply not paid on time--at the end of 1981 Romania had $1.14 billion in overdue payments, of which $0.64 billion was owed directly to Western suppliers of Romania's imports.
- Finally, Romania began attempts to reschedule some of its debts.

Romania is currently negotiating with a group of nine major Western banks --Bank of America, Banque National de Paris, Barclays Bank International, Creditanstalt Bankverein, Credit Lyonnais, Deutsche Bank, Manufacturers Hanover, Societe Generale, Union Bank of Switzerland--a proposal for the limited rescheduling of part of its foreign debt owed to Western banks. The limited rescheduling plan will then be presented to other Western banks and they will be asked to join in it--this is likely to happen in early March. Since the nine Western banks negotiating with Romania have no formal mandate from other banks (unlike in the Polish rescheduling), they will have to persuade other Western banks that it would be to their advantage to participate in the rescheduling. This may well prove to be a fairly difficult task given the following:

- At the end of 1981, according to the official data, Romania owed $10.2 billion to Western commercial banks (including some banks from developing countries), governments, suppliers of imports, and international financial institutions both in the West (IMF and World Bank in Washington) and in the East (IBEC and IIB in Moscow). Out of this amount $9.8 billion was owed to the West (including developing countries) and $0.4 billion to the two CMEA banks. Excluding its obligations to the two international financial institutions in the West, Romania's debt to the West amounted to $8.0 billion on gross basis and $7.7 billion on net basis.
- The maturity structure of the Romanian debt is extremely unfavorable. Including the payments still overdue from 1981, the Romanian government admits that in 1982 it has to repay a staggering 42.6% of the total it owes, or $4.3 billion. Our own analysis concludes that this amount could in fact be somewhat higher, perhaps by as much as 10%.

- Contrary to the impression created by the press, the amount that has to be rescheduled by Western banks this year is not $1.2 billion, but something closer to $2.9 billion ($0.5 billion still owed for 1981 and $2.4 due in 1982--if the rescheduling involves only 90-95% of the debts due, these numbers should be reduced by 5-10%).
- Western banks will also have to raise new loans amounting to perhaps as much as $1 billion to be used for the following purposes: $750 million to pay suppliers of imports delivered prior to 1982 and $390 million to repay guaranteed supplier credits. We are assuming that Romania will be able to obtain a postponement on $0.32 billion in credits to be repaid to four international financial institutions (IMF, World Bank, IIB, IBEC).
- Unconfirmed rumors in the banking community about the exclusion of certain types of commercial loans from the rescheduling--a procedure inconsistent with the precedent of Polish rescheduling, in which all loans with maturity over 1 year were treated the same way--has already created considerable tensions among smaller banks and this will make it more difficult to obtain their co-operation.
- The lack of government participation in the rescheduling may also pose a problem as some banks may perceive their rescheduled loans will be used to "bail out" governments lenders--something commercial lenders never want to do.
- Finally, there is still some doubt that the Romanians have presented us with a true picture of their external financial accounts. For example, at the end of February 1982 we still do not have reliable information on their trade performance in 1981 and it is now certain that most of the information published in the plan fulfillment report in Scinteia last month is incorrect either by design or sheer incompetence of the reporting officials. Regrettably, the trade data supplied by Romania to the IMF and published in the International Financial Statistics also make little sense and appear to be unrelated to any other trade information Romania publishes. What Romania needs is a good audit of all of its external trade and financial accounts either by the IMF or a representative of the Western banks. The information supplied by the Romanian authorities on the country's external financial obligations at the end of 1981, which is presented in the three tables below, has been carefully reviewed by Wharton staff and it appears plausible. However, pending our review of Romania's foreign trade returns in 1981, we cannot rule out that it understates the Romanian external obligations by perhaps as much as $400 million. Thus, Romania's external financial obligations in hard currencies could possibly amount to as much as $10.6 billion, with $4.7 billion falling due in 1982 (including the amount overdue from 1981).

Official Romanian statistics pertaining to the Romanian external financial situation have to be accepted with caution and checked for consistency with the country's foreign trade statistics. Unfortunately, the country's Central Statistical Office and/or appropriate ministries are in a habit of supplying several sets of mutually inconsistent trade and financial statistics--one is

published in the annual Statistical Yearbook, one is sent to the IMF (which is generally most difficult to figure out) and one is published in the press in connection with preliminary report of the country's economic performance in the preceding year.

The table presented below on page 5 represents the preliminary Wharton view of the Romanian foreign trade performance in 1981 pending the availability of consistent and more reliable Romanian data. The numbers in parentheses in the table are those implied by official statistics, with which we disagree and cannot accept until additional information is provided by the Romanian authorities. They imply a $400 million difference in the 1981 convertible-currency trade balance--instead of a surplus of $357 million, we arrive at a $37 million trade deficit. We suspect that Romania may revise its trade statistics later in the year--in the meantime we are inclined to add $400 million to Romania's short-term obligations due for repayment in 1982, bringing the total hard-currency debt at the end of 1981 to $10.6 billion.

Romanian Hard-Currency External Financial Obligations at the End of 1981
(in billion current U.S. dollars)

Type of Credit	Total Amount Owed	Amount Owed to the United States	Amount Owed to Other Countries	Amount Owed to Intl. Fin. Institutions
Bank Credits	6.34	0.42	5.92	
- Without Guarantee	5.41	0.39	5.02	
- Guaranteed	0.93	0.03	0.90	
Guaranteed Supplier Credits	0.91	0.11	0.80	
Credits from Intl. Financial Institutions	2.15			2.15
- IMF and World Bank	1.74			1.74
- IIB and IBEC in Moscow	0.41			0.41
Payments for Imports	0.76	0.02	0.74	
Total Owed	10.16	0.55	7.46	2.15

Overdue Romanian Hard-Currency External Financial Obligations at the End of 1981
(in billion current U.S. dollars)

Type of Credit	Total Amount Owed	Amount Owed to the United States	Amount Owed to Other Countries
Bank Credits	0.49	0.02	0.47
- Without Guarantee	0.47	0.02	0.45
- Guaranteed	0.02	----	0.02
Guaranteed Supplier Credits	0.02	0.0	0.02
Payments for Imports	0.63	0.02	0.61
Total Owed	1.14	0.04	1.10

Maturity Structure of Romanian External Financial Obligations in Hard Currencies

Year	Overdue from 1981	1982	1983	1984	1985	Due after 1986
Amount Due (in percent)	11.2	31.4	14.3	9.5	12.1	21.5

Source: Information supplied by the Romanian government.

Romanian Foreign Trade in 1980 and 1981

	1980	1981		Percentage Growth
Exports to capitalist countries, million dollars	6,805	7,724		13.5
- Developed West	4,207	4,424		5.2
- Developing Countries	2,598	3,300		27.0
Imports from capitalist countries, million dollars	8,208	7,573	(7,173)	-7.7
- Developed West	4,082	3,813	(3,423)	-6.6
- Developing Countries	4,126	3,760		-8.9
Trade balance with capitalist countries, million dollars	-1,403	151	(551)	n.a.
- Developed West	125	611	(1,001)	488.8
- Developing countries	-1,528	-460		-69.9
Adjustment for trade with capitalist countries in non-convertible currencies, million dollars				
- Exports	-302	-343		
- Imports	-171	-149		
- Trade Balance	-131	-194		
Trade in convertible currencies, million dollars				
- Exports	6,503	7,381		13.5
- Imports	8,037	7,424	(7024)	-7.6
- Trade balance	-1,534	-43	(357)	n.a.
Exports to socialist countries, million rubles	3,521	4,336		23.1
- USSR	1,509	1,750		16.0
- Other socialist countries	2,012	2,586		28.5
Imports from socialist countries, million rubles	3,347	3,807		13.7
- USSR	1,383	1,600		15.7
- Other socialist countries	1,964	2,207		12.4
Trade balance with socialist countries, million rubles	174	529		n.a.
- USSR	126	150		19.0
- Other socialist countries	48	379		789.6.

Source: Preliminary Wharton reconstruction based on the official data on total exports and imports and hard-currency exports and imports in 1981.

February 12, 1982

THE CONSEQUENCES OF DECLARING THE POLISH DEBT IN DEFAULT

In recent weeks suggestions have been made that the United States government should declare that Poland has defaulted on its debt. The primary purpose of this action would be to punish the Soviet Union for its involvement in the Polish crackdown since December 13 of last year. It is argued that by declaring Poland bankrupt, we would put the financial burden of the Polish economic recovery squarely on the Soviet Union, which is responsible for imposing the present inefficient and oppressive centrally planned economic system on Poland. Moreover, it is argued, declaring Poland bankrupt would seriously disrupt East-West trade and financial relations and aggravate the Soviet capital shortage. Hence, the Soviet Union, already burdened by the cost of keeping the Polish economy afloat, would be forced to curtail its military expenditures unless its leaders opt to starve their own people or those of other East European countries. In short, the intent is to use the Polish debt to punish the Soviet Union by isolating it and the neighboring East European countries from the rest of the world so that both the oppressor and its victims are left to suffer (and struggle) together.

A secondary purpose of declaring Poland bankrupt would be to punish the Polish military government for its imposition of martial law and suppression of human rights in Poland.

The declaration of Poland's default on its debt would have different impacts on at least five regions of the world: Poland itself, the Soviet Union and the rest of Eastern Europe, Western Europe, the Third World countries, and the United States.

To begin, in the case of Poland, the impact of default may not be nearly as bad as generally believed. Upon being declared bankrupt, Poland would no longer have any incentive to try to service its debt. At this time, the interest cost alone of the Polish debt runs around $2.5 billion annually. Without this expenditure, the country's current account would have been balanced already last year. A default would result in an attempt to attach external Polish assets (deposits in Western banks amounting to several hundred million dollars, Polish ships, property of Polish companies operating abroad, Polish exports) by Poland's Western creditors. However, the value of these assets is relatively small and in most cases such attachment would not even be cost-effective (in view of potential large legal expenses). In order to protect its exports and imports against seizure, Poland could conduct all its foreign trade through intermediaries who would own all imported goods until they reach the Polish border and all exported goods once they cross the border. After default the country's foreign trade would have to be conducted almost completely on a cash basis, i.e., its external accounts would have to be balanced immediately. However, since that is already possible (once the interest payments are eliminated), Poland may not even suffer a significant decline in her trade with the West.

The impact of Polish default on the Soviet Union and the rest of Eastern Europe would probably be more serious than the impact on Poland itself. At the beginning of 1982 the gross hard-currency debt to the West of the Soviet Union, the five other East European countries (excluding Poland) and the two CMEA multinational banks amounts to $65 billion. Approximately $18 billion is in the form of short-term obligations of up to one year owed to Western commercial banks. Roughly one-fifth of this amount, or $4 billion, consists of disguised balance-of-payments loans regularly rolled over. The remaining $14 billion are genuine short-term trade financing credits. The Polish default would result in a severe credit squeeze for the Eastern bloc. It is probable that Western bankers would not be willing to roll over, as they customarily do, a significant portion of short-term loans granted to Eastern Europe. This shrinkage of short-term credit might reach as much as one third of its past level, or $6 billion. In addition, some medium and long-term loans become due every year and the amount of new credit available would not be sufficient to offset the repayments. On annual basis, this shrinkage of medium and long-term debt might reach $3-4 billion.

Eastern bloc reserves held both outside of Western institutions and in Western banks roughly amount to $40-42 billion at current prices. The bulk of this amount is made up of the Soviet gold reserves estimated at 2300 metric tons, currently worth about $23 billion. In addition, the Eastern bloc holds about $9 billion in deposits in Western banks and $8-10 billion in other reserves held in

the respective countries. Without a doubt, the Soviet Union and five East European countries would have severe balance of payments difficulties while the credit squeeze lasted. The critical period would be the first 12 months, during which the total credit shrinkage might reach as much as $10 billion. Afterwards the Eastern bloc would have to adjust to annual net resource outflow to the West of $3-4 billion compared to the 1981 net inflow of $8 billion. If imports from the West were curtailed to the point when trade in goods and services with the West was balanced, then the combined Eastern bloc reserves would be sufficient to withstand a credit contraction lasting several years. Moreover, it should be noted that the international financial turmoil triggered by the Polish default might send the price of gold soaring and enable the Soviets to weather this period with greater ease than expected.

On the other hand, the above analysis is valid only on the assumption that the Soviet Union will extend a full "financial umbrella" over Eastern Europe in the aftermath of the Polish default. If the Soviet Union refuses to do so, then within a period of 12-18 months several East European countries would have to ask that their debt be rescheduled, or be forced into default on their payments as well. This is inevitable since the shrinkage of short, medium, and long-term credit to the five East European countries in one year might reach as much as $7 billion, while their reserves are only in the range of $13-15 billion. In such a squeeze the most vulnerable country would be Romania, followed by Hungary, East Germany, Bulgaria, and Czechoslovakia. The West would be threatened with the prospect of writing off an additional $38 billion on top of the $22 billion already lost in Poland. The Soviet Union might not extend the financial umbrella if its leaders believe that the West would not want to push the rest of Eastern Europe into default. Similarly, if the Soviets perceive this squeeze as an attempt to deplete their gold reserves and increase the external financial vulnerability of the Soviet economy, they are likely to refrain from aiding Eastern Europe. Even with the extension of a Soviet "financial umbrella" over Eastern Europe, the shrinkage of credit would cause significant reduction in East-West trade as new equilibrium would be found compatible with a permanently lower level of trade financing. In addition, East European imports would probably have to be drastically curbed in order to earn trade surpluses and repay some medium and long-term credits coming due.

The impact of a U.S. decision to unilaterally declare Poland in default would be rather far-reaching for Western Europe. Western European banks and governments would have to write off $14 billion in Polish debt and this might trigger a major financial crisis in Western Europe. Several West German, U.K., French and Austrian banks would be in serious financial difficulties and two or three could be threatened to the point of collapse. Assuming that the Western European governments would step in and aid commercial banks, Western Europe would probably be able to prevent a large-scale banking crisis during the initial impact phase of the Polish default. It is another matter how Western Europe would be able to handle the second, far more serious, crisis which would probably occur within 12-18 months after the default. Assuming that the objective of the U. S. policy would be the maximum disruption of East-West trade and financial relations, and

hat the U.S. would engineer a credit squeeze aimed at the rest of the Eastern loc, the potential cost to Western Europe of this escalation in economic warfare ould be far greater than the $14 billion write-off during the first round. The otal amount at stake for Western Europe, which might be lost if the Eastern loc was forced to default on its debt, is about $50 billion.

The region that ultimately might be hurt most as a result of Polish default ould be the Third World. By declaring Poland in default, the U.S. government ould send a clear signal to commercial banks all over the world that it can and s willing to use default as a means of punishing countries whose policies are iewed as unfriendly to the U. S. This in turn would sharply increase the lending isk in many Third World countries and would make commercial banks hesitant to xtend existing loans and issue new ones. The worldwide contraction of commercial ending to the Third World countries would shift the lending burden onto Western overnments and international lending agencies. Without intending to do so, the J. S. declaration of default against Poland would probably create a major lending risis in the Third World and it is actually possible that a few Third World ountries might be forced into default as well.

The direct financial impact of the Polish default on the United States would ot be significant, but the same could not be said about the indirect impact. otal U.S. exposure in Poland is less than $3 billion, compared to more than $14 illion for Western Europe. None of the U.S. commercial banks has more than $150 illion in Polish loans and even if the banks wrote off all these loans, it might erely reduce their net income in one quarter. The after-tax losses of the U.S. anks from Polish default could reach at most $650 million, but are actually likely to be less. Therefore, it is clear that if the U. S. government desired to se the Polish default as a means of hurting the Soviet Union, it could use this olicy step at a relatively low domestic cost. What the proponents of the Polish efault have not made clear to the public is that the moment the U. S. declares default, U.S. taxpayers will immediately have to pick up a tab amounting to $2.4 illion representing $1.9 billion in U.S. government-guaranteed credits to Poland and $500 million in tax write-off claims of commercial banks. If default is not declared, then the most U.S. taxpayers will have to cover during the coming year is the assumption of about $450 million in government-guaranteed credit. To the degree that there is hope that some of these loans will be repayed by Poland in the future, the above amount should be reduced correspondingly.

The indirect cost of Polish default to the U. S. would probably be far greater than the direct cost. For example, it is likely that at least one European country of considerable strategic value to the West because of its unallied nature--Yugoslavia--might be pushed "to the brink" by this policy step as well. Regrettably, commercial bankers increasingly tend to view Yugoslavia as a similar lending risk as the rest of CMEA and Yugoslavia probably could not survive the post-default credit squeeze without Western government financial assistance. If the U. S. declared Poland in default, Western Europe would legitimately put the burden of keeping Yugoslavia afloat on the U.S. government. In fact, Yugoslavia may not be only country threatened by the Polish default in which the U.S. has strategic interest and the U. S. government would probably have to mount

a multibillion dollar aid effort to several countries in Latin America, Africa, and Asia to prevent them from suffering Poland's fate.

Default is an inflexible policy tool because it implies a policy step which is not reversible. Sustained economic pressure on a country is far more effective because it can be increased or relaxed depending on the country's response. In fact, the Polish political crisis has already produced a serious credit squeeze for the economies of the Eastern bloc without declaration of default. Commercial banks now perceive Eastern Europe, and increasingly the Soviet Union, as far greater economic and political credit risks and are not willing to make any new large-scale loans in the East. If the pressure continues, it is likely that Western commercial banks will start refusing to roll over some existing credits and begin to reduce their lending exposure in the East.

By declaring the Polish debt in default, the West would eliminate its key lever for encouraging economic reform and political liberalization in Poland. That is not to say that default itself is not a key lever as well--rather that it should be used as a last resort in a situation when there is no longer any hope of influencing the developments in Poland. Once the West decides to use the "stick"--declaration of default--its leverage on the Polish military government is gone. The Polish government would be free to pursue policies as it pleased with little reason to concern itself with Western interests. It is likely that the government would delay the introduction of economic reforms and political liberalization citing the Western economic and political warfare aimed at Poland, and would seek Soviet assistance to solve the country's economic and political problems, possibly including a request for direct military intervention if it cannot contain the opposition from the population. In short, the default may push Poland deeper into the Soviet orbit and would represent a complete reversal of a twenty-year old U.S. effort to encourage increased Polish independence from the Soviet Union.

Appendix

POLISH HARD-CURRENCY MEDIUM AND LONG-TERM DEBT
AND ITS MATURITY SCHEDULE AS OF AUGUST 31, 1981
(million current dollars)

Country	Total	Debt Maturity Schedule				
		1981	1982	1983	1981-83	After 1983
Total	23,421.5	4,764.7	6,360.0	4,374.6	15,499.3	7,922.2
- guaranteed	12,324.7	2,252.3	3,093.6	1,967.0	7,312.9	5,011.8
- non-guaranteed	11,096.8	2,512.4	3,266.4	2,407.6	8,186.4	2,910.4
Non-socialist Countries	21,151.1	4,306.5	5,785.5	3,696.0	13,788.0	7,363.1
- guaranteed	11,250.7	2,243.4	3,081.4	1,958.3	7,283.1	4,967.6
- non-guaranteed	8,900.4	2,063.1	2,704.1	1,737.7	6,504.9	2,395.5
Developed West	18,587.1	3,798.4	5,042.6	3,154.0	11,995.0	6,592.1
- guranteed	11,106.6	1,939.0	2,698.4	1,836.4	6,473.8	4,632.8
- non-guaranteed	7,480.5	1,859.4	2,344.2	1,317.6	5,521.2	1,959.3
Developing Countries	2,564.0	508.1	742.9	542.0	1,793.0	771.0
- guaranteed	1,144.1	304.4	383.0	121.9	809.3	334.8
- non-guaranteed	1,419.9	203.7	359.9	420.1	983.7	436.2
Socialist Countries	2,270.4	458.2	574.5	678.6	1,711.3	559.1
- guaranteed	74.0	8.9	12.2	8.7	29.8	44.2
- non-guaranteed	2,196.4	449.3	562.3	669.9	1,681.5	514.9

WHARTON ESTIMATE OF THE POLISH HARD-CURRENCY DEBT
AS OF DECEMBER 31, 1981
(million current dollars)

Gross total debt	25,500
Deposits in Western banks	550
Net total debt	24,950
- Non-socialist Countries	22,550
- Developed West	19,900
- Developing Countries	2,650
- Socialist Countries	2,400

February 22, 1982

SOVIET GAS PIPELINE MAY BRING MORE OIL TO WESTERN EUROPE

Most analysts of the Soviet economy have concluded that the Soviet Union badly needs to increase gas exports to Western Europe by the mid-1980s to supplement what they expect will be declining hard-currency earnings from oil sales. Without increased gas sales, they expect the Soviets will not be able to sustain the level of imports of Western technology, grain, raw materials and semimanufactures to which they have grown accustomed in recent years. For this reason, it is believed, the Soviets are now in the process of building several gas pipelines to the Soviet-Czechoslovak border which are expected to reach 5 trillion cubic feet (tcf) export capacity per year compared to the present capacity of 2 tcf. Western Europe has already contracted to buy 2.12-2.30 tcf of Soviet gas per year by 1985/86, and it was widely accepted that Soviet gas exports to Western Europe might reach 3.50 tcf by 1990, with the remaining 1.50 going to Eastern Europe.

However, it is increasingly probable that the Soviets do not intend to increase their gas exports to Western Europe much beyond the 1985 level for which contracts have already been made. Instead, with the help of Western financing they intend to expand their domestic gas distribution network and their export capacity to Eastern Europe. By substituting natural gas for oil domestically and in Eastern Europe, the Soviets expect to free enough oil for export to earn the hard-currency they need. An advantage of selling oil instead of natural gas to Western Europe is that the Soviets would not have to worry about United States government pressure to limit Western European dependence on imports of Soviet gas. Oil is a commodity traded on the international market without much attention given to its origin and it is next to impossible to prevent the Soviets from selling as much oil as they want. In addition, Soviet exports of oil to Eastern Europe are the main carrier of hidden trade subsidies and have high opportunity cost to the Soviets. The price of Soviet exports of gas to Eastern Europe, however, is much closer to what the Soviets can earn in Western Europe. By forcing Eastern Europe to substitute imports of Soviet gas for Soviet oil, the Soviets are substantially reducing--though not eliminating--these trade subsidies. Thus, the substitution of gas for oil can simultaneously solve two very pressing problems.

At the end of the 1970s it became increasingly apparent to the Soviet planners that they could not hope to sustain the physical quantity of their oil exports to Western Europe because of the declining growth rate of domestic oil production coupled with increasing domestic consumption. Since oil accounted for more than one half of Soviet export earnings in Western Europe, the Soviets had to

make a decision--either to boost oil production and increase exportable oil surplus or to increase output of gas and rely on gas exports to partly replace and supplement oil earnings. Both options required huge capital expenditure with large imported components (pipes, pipe-laying equipment, pumping and compressor equipment, drilling equipment, etc.) and could only be financed with substantial Western participation.

Growth in oil production has been more difficult to achieve than growth in gas output for several reasons. The Soviet Union has already exploited most of its more accessible sources of oil while vast deposits of natural gas in Western Siberia have yet to be opened up. In terms of combined production and transport cost per calorie, natural gas is considerably cheaper than oil. No major effort to increase oil production could be mounted without significant U.S. cooperation which was not forthcoming because of the U.S. government opposition to a major deal between U.S. oil companies and the Soviet Union. Moreover, the Soviets probably would not have been willing to agree to an oil production sharing formula that U.S. companies would have insisted on.

The gas option looked considerably more attractive. It permitted the Soviets to propose to Western Europe a huge equipment-for-energy deal and get most of it financed at attractive interest rates by Western banks and governments. Initially, the financing was to cover at most 85% of total cost, but recently France set a precedent by financing the full 100% of its share of the project. Another attractive aspect of the gas option was the possibility of attracting far more financing for the project than was actually necessary for construction of the pipeline.

On the strength of projected annual Soviet gas export earnings of $10.6 billion by 1985-86 ($7.1 billion on a net basis when we exclude the cost of servicing the debt incurred in connection with pipeline financing), the Soviets will probably be able to import $20 billion worth of pipe, compressors, and other equipment for the West European line and the other five large-diameter gas pipelines to be constructed during 1981-85. The bulk of this will be financed by credits from Western banks and governments at rates below 8%, compared to world market dollar interest rates of 13-15%. Since the actual hard-currency cost of the West European portion of the pipeline will be in the $5-6 billion range, the Soviets are in essence double- to triple-financing the West European line.

This additional financing can be used to expand the domestic gas distribution network and increase export capacity to Eastern Europe. It would also give the Soviets a very flexible energy export base for the 1980s and 1990s: they could offer to sell more gas to Western Europe (over and above the amounts contracted for delivery through the West Siberian export pipeline); they could use more gas at home and sell more oil in the West; and they could provide more gas to Eastern Europe while diverting oil exports to Western Europe. With the mounting pressure from the U.S. government against increasing Western European dependence on gas imports from the Soviet Union, the latter two options look increasingly attractive to the Soviets.

Another reason the Soviets are interested in selling more gas, and less oil, to Eastern Europe is the the difference in opportunity costs of these exports. In 1981, the Soviet Union sold 526 million barrels of crude oil to Eastern Europe at the average price of $17.10 per barrel (at the official Soviet exchange rate of $1.385 per 1 ruble) compared to the average world market price for such oil of about $35 per barrel. Hence, the opportunity cost of selling this oil to Eastern Europe was $9.4 billion ($17.90 times 526 million barrels) assuming Soviet sales would not substantially affect world market prices. However, an additional subsidy in oil sales of perhaps as much as $3.5 billion is incurred on top of the above amount since the Soviets accept overvalued inconvertible rubles as means of payment instead of convertible dollars. (The commercial value of the ruble is about $0.85, i.e., 39% below its official rate.) Thus for any barrel of oil sold to Eastern Europe in 1981, the Soviets earned in effect only $10.50, compared to $35 obtainable on the world market.

In contrast, the average 1981 Soviet price for exports of natural gas to Eastern Europe amounted to about $2.77 per thousand cubic feet at the official dollar/ruble exchange rate ($1.70 at the commercial exchange rate) compared to about $3.70 for gas sold to Western Europe. Thus, if the official rate of exchange is used as the standard of comparison, the Soviets could obtain almost 75% of the Western European price for their gas exports to Eastern Europe but only 49% for oil. Moreveor, the Soviets could not obtain the price of $3.70 per thousand cubic feet of gas if they wanted to boost their gas exports to Western Europe to Western Europe dramatically. On the other hand, extra Soviet sales of crude oil would be less likely to depress the world market price because the world oil market is so much larger than the West European gas market. This in turn makes gas an even more attractive commodity to export to the East instead of the West.

Already in 1982, the Soviets have announced that they are cutting back oil deliveries to all Eastern European countries except Poland by 10%. Soviet exports of oil and oil products to five Eastern European countries (except Poland) will be cut from 467 million barrels to 420 million barrels. Of the 47 million barrels held back, 22 million barrels will be sold to Poland to replace imports of crude oil from the Middle East and Western Europe which Poland can no longer afford, and 25 million barrels can either be sold in the West (or to the East--but for hard currency) or used within the Soviet Union. It is likely that the Soviets will offer increased gas deliveries to Eastern Europe in compensation for reduced oil deliveries. The option of buying more gas, however, is a costly one to Eastern Europe for the reason outlined above.

It is very unlikely that pressure from the U.S. government can stop the construction of the West European line. Because of this pressure, however, it is probable that the Soviets will follow the second or the third of the above options, or both simultaneously. Thus, although the U.S. government is not likely to be successful either in reducing West European overall energy imports from the Soviet Union or in preventing the Soviets from continuing to earn substantial revenues from sales of energy in Western Europe, its actions may well result in the Soviets selling more oil and less gas than otherwise to Western Europe. Hence, vulnerability of Western Europe to the threat of Soviet energy export cutbacks would be reduced, since, in a crisis, substitutes for Soviet oil could be found more readily than substitutes for Soviet gas. Finally, increased Soviet oil sales in the West would put further downward pressure on world market oil prices -- a welcome additional benefit to the U.S.

Senator KASTEN. We have only a limited period of time because there is another meeting that is going to be taking place in this room, and we have to give them a chance to clear out the room.

I want to thank you for the facts that you have provided us.

In one area, you mentioned a minute ago, and I just want to make sure it is clear. You said in order to affect the Soviet Union, we would have to cause very serious financial problems among the Eastern bloc countries. I agree with that, and I understand that, and frankly I am willing to do that. But you made another point when you talked about the Third World and Yugoslavia. I have gone further in looking at the situation, particularly examining Brazil and Mexico who you can argue are in precarious positions in terms of overextended borrowing.

Are you familiar with the cable that Dr. Arthur Burns wrote from Germany to the State Department here? It was in late December at a time when all of the European Ambassadors were asked to analyze the effects on the banking systems of Europe and the banking systems in their particular country of calling the Polish debt in default.

The cable was reprinted in part in Wall Street Journal, and there was an editorial in the Wall Street Journal which essentially said that Dr. Burns felt that it would have an important impact on the German banks. Although he didn't name the banks, there are five banks in particular that would be affected. He felt that it would not have a calamitous effect on even the German banking system and it would not have this ever-expanding problem. In other words, the problem would not go beyond the Eastern bloc countries and the Soviet Union.

You are the first witness that I have heard in listening to and reading what the Banking Committee has done, and listening to and reading what the Foreign Relations Committee has done, and with the numerous testimony we have had that makes that extension outside of the banking systems of America and Germany and the Soviet bloc countries.

I just wanted to point out that the extension into the Third World is not one that most economists or bankers are making right now.

Dr. VANOUS. I am familiar with what Ambassador Burns said, but Ambassador Burns said that none of the banks would ultimately be probably threatened to the point of collapse because what he visualized is of course the taxpayer bailout.

Senator KASTEN. The Soviet bailout.

Dr. VANOUS. Well, the taxpayer bailout of the German banks in a sense, because as you write off the Polish debt to begin with you could probably write half of it against your future income taxes, like in this country the corporate income tax would be 45 percent. Therefore, for any $1 loss of assets in essence you could write off 45 cents against your income tax.

Moreover, it is probably that there will be some outright grants by the U.S. Government to some of the banks really to get them through this crisis period. But that is somewhat of a different issue. I don't see how anybody could compel major Western banks to continue lending

to some countries where they feel there is now a significant risk of default basically for political reasons.

I think increasingly what you would have is Western bankers trying to think much more like politicians, and trying to predict which particular government perhaps has influence over debts in a particular country, may not view that country friendly and could use default as a political weapon.

Now the whole process of lending to many countries would be politicized and bankers would have to start being very much concerned not only about evaluating the possibility of being repaid, that is the soundness of the economy but also the political factors. In the light of this they would try to certainly reduce exposure in countries where such political risks are perceived to be significant.

Senator KASTEN. I have one further question. In your February 12 analysis you say that by declaring Poland in default the United States would effectively, through some kind of a chain reaction, cut off all Western credit to the Soviet bloc. In other words, that is where it would lead. If that in fact is your position, what effect do you believe then a declaration of default would have on supply of the credits to the Soviet Union, in particular, for the credits needed to construct the Soviet natural gas pipeline?

Dr. VANOUS. Our position was somewhat different. We visualize that our objective in declaring Polish default, if we have that objective we would in fact insist on a cutoff of all lending because if we are going to have an economic warfare with the East it doesn't make sense to go half way, and you might as well go all the way.

Then as far as the effect of such a cutoff on lending on the pipeline, I feel that possibly it could be effective, but it is probably going to be the very last thing that would be affected.

Senator KASTEN. First they would cut their defense spending?

Dr. VANOUS. No, I mean in terms of what credits would be cut off first. First of all, you would cut off short-term credits to Eastern Europe, and then you would start cutting off longer term credits to Eastern Europe, and then you would cut off short-term credits to the Soviets and ultimately last, if the political environment continues, some of the West European countries would have second thoughts about extending even long-term credits.

Senator KASTEN. But that would be the last?

Dr. VANOUS. That would be the last. In terms of affecting Soviet defense spending, I don't feel that any of this is going to affect Soviet defense spending because the Soviet Union is not a country like the United States where we have a democratic society, and if there is a great increase in defense spending, it has to be supported generally by the workers. That is not how it is done in the Soviet Union. Defense spending is the line No. 1 in the government's budget. Now if you are going to lose some of the income, first of all, you will start cutting from everything else before you touch defense.

Furthermore, by declaring economic warfare on the Eastern bloc and on the Soviet Union we have created a credible threat, which in turn can be used by the Soviets to support an increased defense effort because they need to persuade their population. Although it is not a democratic country, they need to have a credible threat from the West so as to be able to sustain the high rate of defense spending. Once we create it for them, that is a justification for tightening, for reducing consumption and for reducing investment basically to protect defense spending.

I feel that the amounts that are involved aren't really significant enough where we can dramatically affect Soviet defense spending. It is such an overriding objective with the Soviets to maintain security. Moreover, the Soviets would probably look for some way to retaliate on us, and there are certainly plenty of possibilities where they can hurt us rather badly, and it is a question of what it will do to our defense spending.

Senator KASTEN. I respect your opinion, and I know that you respect my opinion and the opinion of many others who have testified in a very different manner on that particular question. Although the Soviet Union is not a democracy, and they don't need popular support for their defense spending, they do need to maintain a certain amount of consensus and calm within their own people and the people in the Eastern bloc.

As they go through more and more hardship and as more and more people are going without food and as more and more people are going without the necessities of life, the pressure on the Polish Government run now by Soviet proxies, and the pressure on the population from any of the other satellite countries and the pressure that the Soviet people themselves can put on the Soviet Government is something that many people feel is significant and could be significant.

There is increasing unrest among all of these people as a result of this tremendously skewed economy going toward no security but toward offensive military capability that is not defensive security. That set of priorities which the Soviet leadership has set without any kind of restraints from the people is one that many believe is putting increased pressure on them.

We appreciate your testimony before the committee and particularly the detailed financial analyses that you have provided. It will be of great help in the record and of great help to us as we examine this problem.

SUBCOMMITTEE RECESS

I appreciate your joining us and thank you for your testimony. The subcommittee stands in recess.

Dr. VANOUS. Thank you.

Senator KASTEN. Thank you very much.

[Whereupon, at 3:50 p.m., Tuesday, March 16, the subcommittee was recessed, to reconvene at the call of the Chair.]

POLISH DEBT CRISIS

WEDNESDAY, APRIL 21, 1982

U.S. SENATE,
SUBCOMMITTEE ON FOREIGN OPERATIONS,
COMMITTEE ON APPROPRIATIONS,
Washington, D.C.

The subcommittee met at 10 a.m., in room 1223 Everett McKinley Dirksen Senate Office Building, Hon. Robert W. Kasten, Jr. (chairman) presiding.

DEPARTMENTAL WITNESSES

SUBCOMMITTEE PROCEDURE

Senator KASTEN. The subcommittee will come to order.

It has been 2½ months since this subcommittee first held hearings on the question of Polish debt, U.S. policy with respect to that debt, and other questions relating to the provision of credits to the Soviet Union and its satellites.

The military dictatorship in Poland is more firmly entrenched in power and the Polish people oppressed as never before. Yet our policy with reference to sanctions toward that government are as weak now as they were 2½ months ago.

This subcommittee had hoped that one of the results of the mission by Under Secretary Buckley would have been a change in our policy—a stronger and tougher policy.

I would also like to make it clear that this subcommittee was told in hearings held in February, and I was also told by people at the National Security Council, the Defense Department, the State Department, and the Treasury Department that the reason that a number of questions were still open or that our policy was not clearly defined, vis-a-vis the Polish debt and credits to the Eastern bloc, was we were waiting for a mission.

At one time I was told it was going to be the Buckley mission, but we were told not to talk about it being the Buckley mission because it was still under discussion whether or not it would, indeed, be the Buckley mission.

We were waiting, and now we see that instead of a stronger and tougher policy, we see that one of the things that I warned against earlier has already happened. That is, that this issue is being put on the

back burner; the bankers are already pressing for a return to the status quo and there is quite a bit of talk of more new credits.

This morning we have Under Secretary of State James Buckley as our first witness. He will present testimony relating to his mission to Europe.

After Secretary Buckley's testimony, we will have a panel consisting of witnesses from the Departments of Treasury, State, Commerce, and Defense. I should note that the State Department witness is going to be Charles Meissner rather than Thomas Niles, and that since the subcommittee notices were sent out, we have added Stephen Bryen as a member of the panel.

I might just add that in the process of getting this hearing going we have gone through the most extraordinary negotiations that I have known as chairman of the subcommittee.

Secretary Buckley and I made an agreement that he would present his testimony, but he would not make himself available to questions on the negotiations. I agreed to that.

The next day he wanted that assurance in writing to the Department of State, and we decided that my word was probably good enough. The next day we found out that people from Defense, State, Commerce, and Treasury found out that Mr. Buckley was not going to have to answer questions. Therefore, they thought they shouldn't have to answer questions.

I have to say it is clear to me that we are not making the kind of progress we want on this issue: That people in the Government are confused and in some cases at odds with one another; that the issue was not getting the kind of attention it ought to get; and that we apparently have wide divergence between the positions taken at the Department of Defense and the positions taken at the State Department with regard to this issue, particularly with reference to the importance of the NATO alliance versus a get-tough policy on our allies.

I note in your statement you carefully define what your mission wasn't, but as I said before we were told in February that this is exactly what your mission was.

Therefore, under these complicated circumstances, we would like for you to begin your testimony.

I might also add that one of the things we have been trying for is to get testimony from the State Department at least a day in advance, ideally 48 hours in advance.

I am told we received a first draft of your testimony at 6:30 last night, and it was revised after that. I would hope that we can do better in the future.

Let us go foward with your testimony, and after you speak we are going to set up a panel of people that will in fact respond to questions.

I want to assure you that this is an issue that I believe is very, very important. It is an issue that I believe this administration is not focusing on, and it is an issue on which I believe the administraton has become kind of lackluster. This is at a time when we have major problems with the Soviet bloc countries, and I believe major opportunities if we can limit the credits.

I think we need to spend a lot more time and pay a lot more attention to these particular problems. Please proceed with your prepared statement.

STATEMENT OF JAMES BUCKLEY, UNDER SECRETARY FOR SECURITY ASSISTANCE, SCIENCE AND TECHNOLOGY, DEPARTMENT OF STATE

Mr. BUCKLEY. Thank you, Mr. Chairman. I do appreciate this opportunity to define the mission the President has asked me to lead, because its mandate is narrower than is generally understood.

I also want to thank you for your understanding of the fact that because we are engaged in continuing, highly sensitive negotiations with a number of allies, it is not appropriate for me—or others for that matter—to discuss the negotiations themselves.

OFFICIAL EXPORT CREDITS AND CREDIT GUARANTEES

Our mission's primary goal was, and remains, to work with our allies to achieve significant restrictions in official export credits and credit guarantees to the Soviet Union. I emphasize the words "official" and "Soviet Union," as our mission is not concerned with any part of the credit situation in the East European bloc or with the extension of commercial credits to the Soviets.

The basic concerns on which our efforts rest is that Western nations, through their policies of government-supported credits, have given the Soviets access to significantly larger amounts of hard currencies than would otherwise have been possible based on their own resources and credit worthiness.

As a consequence, in our judgment, the West has in effect helped subsidize the modernization of the Soviet industrial base, hence of its warmaking capabilities.

At the same time, these credit policies, over the last 10 years, have facilitated the creation of a large and growing debt exposure in the Soviet Union which threatens to grow to dangerous proportions, if not checked.

What we are seeking to establish, in short, is a consensus that will view the continued uninhibited extension of officially supported credits to the Soviet Union as strategically and financially imprudent, and thus result in appropriate restrictions.

The President also asked us to take advantage of our meetings to express our concern over the potential for an excessive dependence by Western Europe on Soviet natural gas and to urge that commitments to the Soviets be kept at a minimum while alternative sources of energy were thoroughly explored. We have, and will continue to point out, for example, that there are economically viable and more secure non-Soviet energy alternatives; namely, North Sea gas and U.S. coal.

Mr. Chairman, I have provided you with the sum total of the President's instructions. We did not go to Europe to seek to cut off trade with the Soviet Union or Eastern Europe; or to address the Polish debt; or the imposition or extension of sanctions. Nor were we directed to try to block the Yamal pipeline.

Rather, our prime objective, as I have stated, was to convey the President's deep personal concern over the degree to which official credits have helped to strengthen the Soviet Union, and to initiate discussions which we hope will lead to the establishment of a mechanism for restricting such credits in the future.

To this end, we have held a number of subsequent consultations on a bilateral basis with the view of holding multilateral meetings, at which agreement on such a mechanism could be reached.

Thank you, Mr. Chairman.

Senator KASTEN. Due to our previous understanding, we will not ask you questions on this subject at this time. Instead we will go now to a panel of representatives of the various departments, some of whom I understand either accompanied you on the mission, or at least were in touch with some of those who did accompany you on the mission.

I just want to emphasize that the concern that we have is that you very carefully defined what your mission was not. That is precisely the opposite of what we were told your mission was going to be.

We were told the focal point of the administration policy in this area would be the point of your mission. So one of the questions I am going to ask each of the others, and I don't expect you to answer it, but the question is that if your mission was not the focal point of the administration policy on the Polish debt and the questions of overall credits et cetera, then I hope that there will be another mission or at least a focal point or whatever is necessary to get at this problem.

I am going to ask if there is going to be another mission or if there is going to be an effort made to concentrate on the Polish debt and the Eastern bloc credit situation and to take this beyond the government credits and also to get involved in the commercial credits, as well.

As you know in the case of Germany, there are gray areas as to whether it is the government or not, and it is something that this subcommittee will continue to explore.

I very much appreciate you coming before us today, and I look forward now to statements from the panel.

Thank you very much.

Mr. Marc Leland isn't here yet. We have Mr. Meissner, Mr. Bryen, and Mr. Denysyk. Mr. Leland told us that he had an urgent meeting he was attending, and he would try to be here. I assume either he will be here or a representative of his will be here.

First of all, I would like to ask each of you to make a brief comment on your view of the situation, and I also would like for you to address the question. A number of you or at least one of you were in the room in February when we had discussions with Mr. Hormats and Mr. Leland and others, at which you heard them say that this whole question was going to be dealt with, in part, by the Buckley mission.

In addition to your expression of concern and your evaluation of the overall situation, I would like to ask whether you believe that there will be another mission to explore the overall question, because this one was so narrow, and whether you believe that that would be a valuable thing for us to push for.

Mr. Bryen, why don't you start.

Mr. BRYEN. Why don't we start with the State Department and come back to Defense.

STATEMENT OF CHARLES MEISSNER, SPECIAL NEGOTIATOR FOR ECONOMIC MATTERS, DEPARTMENT OF STATE

Mr. MEISSNER. Mr. Chairman, I know of no plans to have an overall, as you said, mission that would discuss with our allies all aspects of our relationship with the important Warsaw Pact countries or directly with the U.S.S.R.

CONSULTATION WITH ALLIES

We are carrying out consultations through NATO, through COMECOM, through creditor meetings and so to some extent broader discussions within the OECD, on economic relations of the OECD countries with Warsaw Pact countries.

But there is no umbrella in terms of an individual mission or a perceived conference or a gathering of any type that would have as its main objective the discussion of economic relationships with the Warsaw Pact countries.

Senator KASTEN. I want to give each of you a chance to answer. Let me follow up on one question.

Secretary Buckley said he was concerned only with Government credits and Government financing activities. Is the scope of your discussions including commercial credits and financing activities, as well as Government?

Mr. MEISSNER. Only insofar that they may be guaranteed or insured by Government agencies, but not straight commercial relationships.

Only commercial relationships that are either insured or guaranteed by governments, or direct loans by governments, are involved. We are not involved in any discussion of direct commercial relationships in which governments have no part.

Senator KASTEN. So it would include below market financing and other subjects such as terms of guarantees, for example, that the Germans were involved with?

Mr. MEISSNER. Yes.

Senator KASTEN. It would include that general group of transactions?

Mr. MEISSNER. Yes.

Senator KASTEN. Mr. Denysyk.

STATEMENT OF BOHDAN DENYSYK, DEPUTY ASSISTANT SECRETARY FOR TRADE ADMINISTRATION, DEPARTMENT OF COMMERCE

Mr. DENYSYK. Well, I don't have much more to add to what the Department of State said other than the issues that you mentioned earlier, energy, undermining European sanctions and so forth and so on, being on the back burner. In fact, in most agencies they are very much on the front burner.

The focal point, though, is not followup to the Buckley mission or the Buckley mission to begin with. The issues involve different types of people with different expertise, so they are being treated in different forums. Let me take one.

On the energy issue, we are having bilateral discussions with our allies on that issue, and we are dealing with that in multilateral forums, dealing with it on the fringes, on areas like expressions for the summit and so on.

So it is my feeling that the issues that you mentioned earlier are being dealt with, being dealt with in a rather aggressive way, I might add. Beyond that, if you would like to pursue some areas I would be glad to go on.

Senator KASTEN. I would like to follow that up. If it is being dealt with in a coordinated and aggressive way, it is the best kept secret in town. We have a splattering of newsclippings on these issues that have been trickled out by people mostly on a "not for attribution" basis, and I have seen little or no activity.

I saw the article this morning in which six banks decided not to go along with the system on the Polish debt, but I see little or no activity. If this is going on, with whom specifically and at what level?

Are you saying that the Secretary of Commerce, the Secretary of State, and the Secretary of the Treasury are actively working on this, and do we have a coordinated policy, and is it being done at the National Security Council? Where is it going on if we are actively pursuing this? I don't see it.

Mr. DENYSYK. Well, you would have to identify which issue you are talking about or we are talking about. The default issue has been discussed in a number of areas in the past few weeks.

Senator KASTEN. Where?

Mr. DENYSYK. Well, it was mentioned on the margins.

Senator KASTEN. They just said it wasn't part of the mission.

Mr. DENYSYK. It wasn't a part of the mission.

Senator KASTEN. But on the margins?

Mr. DENYSYK. People bring it up, and we suggest that a better forum for that would be discussions in BIS, and a bilateral forum, and so I think one would need to identify which issue.

Senator KASTEN. Let us identify them. The Polish debt default is one issue, and in my mind and in the views of this committee, that is simply a small part of the larger issue of the extension of credits and of financing to Soviet satellite countries.

Now, it would seem to me that we can talk about both of those issues at the same time. You said that on the margin of the Buckley mission there were meetings before and after, and this was discussed, although it was not a part of the mix. Now, tell me about those meetings, and what was going on and what is our position.

Mr. DENYSYK. Again, as Secretary Buckley mentioned, details of the discussons we are not at liberty to discuss.

Senator KASTEN. I am not asking you about the mission. The details of the negotiations were not on the question of Polish debt. You said that there were other dicussions about that, that was not a part of the negotiations, so you ought to be able to respond.

Mr. DENYSYK. In a very general point of view, the arguments we have been trying to make are that we have lent too much money at concessional rates to the Eastern bloc.

As an example, look at Poland or Romania. In that context, it came up frequently, but how to deal with that and how to pursue it specifically, that wasn't dealt with in the Buckley mission. It was before another forum.

It is linked in the sense that it is an example of bad fiscal management on the part of the Western countries. But how to deal with it wasn't discussed.

Senator KASTEN. We will get back to that.

Mr. Bryen, why don't you make a few brief comments as to the importance of this question, what you see being done, and if you believe there is going to be a focal point. If the Buckley group was defined as everything it was not, where is the focal point to deal with these issues?

STATEMENT OF STEPHEN D. BRYEN, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL ECONOMIC, TRADE AND SECURITY POLICY, DEPARTMENT OF DEFENSE

Mr. BRYEN. Well, let me first begin, Mr. Chairman, by saying that the objectives of the Buckley mission Under Secretary Buckley decribed today are terribly important. While it is obviously targeted on the official credits and guarantees that might go to the Soviet Union, I think it is clear to all of us that the commercial world will tend to follow rather than lead what governments do.

This has been the pattern when heavy lending was undertaken to the bloc and to the Soviets specifically in the past. It was the leadership of governments that involved the banking community in this kind of process.

So it stands to reason that if there is a substantial reduction in officially guaranteed loans and credits to the Soviet Union, there would be a related substantial reduction in the commercial lending world.

The whole purpose of this exercise is to make an effort to see to it that we are not subsidizing the Soviet military development expansion. We hope to induce the Soviets to have to make some of the choices we often have to make between the civilian sector and the defense sector.

It is a choice that in the last decade or more they hadn't made. The result has been a steady expansion of their military capabilities, and it is an expansion we have to take account of, and we have to similarly invest resources in defense.

So I think it is an important scenario. It is an important effort, and it shouldn't be underrated. There are all kinds of collateral issues. You quite rightly mentioned the Polish debt issues and the West Siberian pipeline issue that we in the Defense Department have been concerned with.

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I would like to mention that it is somewhat nontraditional for the Defense Department to be as deeply engaged in these matters on the economic front as we are presently, and we are to a certain extent learning our own way.

We were asked by the White House recently to look at energy alternatives in relationship to the Siberian pipeline project, because of the obvious impact that that also could have on our allies, and we have done that.

We completed a report that we are very excited about, that indicates that there are very substantial natural gas resources in Western Europe, much more than we happen to have in this country, that could supply European needs through this century or beyond.

We think that this leads to the conclusion that the Siberian pipeline is an unnecessary adventure, and that it will only draw down on Western economies and not contribute to them.

So we are hoping and we intend to follow that up in many ways.

Senator KASTEN. I hope you do, but it is my understanding that right now our position is that we have decided against trying to limit the reexports of certain kinds of equipment. We have decided not to put pressure on American subsidiaries to either delay or to eliminate the machinery and equipment that will make that pipeline possible.

It is also my understanding that there was an assessment made that even if we did put on that maximum pressure, all we could do was slow it down by maybe 6 months to a year, based primarily on the fact that their schedules were already too optimistic.

We might be able to slow it down, but they are going to be slowing it down on their own.

Could you discuss that question?

Mr. BRYEN. I think I can. First on the nature of any decision that has been made, we do have a set of actions that we are agreed on, as you know, of the Poland situation. When martial law came in they haven't been altered to my knowledge.

What I am saying there, in effect is that as far as the issues of delays on the pipeline, there are some natural limitations on what we can do if we proceed only in that way. That is to say only through sanction processes.

I would be prepared to discuss it with you in closed session, some elements and I think it would be better to be done there. But as far as the objective is concerned we have an obligation to a certain extent because we have a direct interest.

Senator KASTEN. An obligation to whom?

Mr. BRYEN. To our allies, that if they have a requirement——

Senator KASTEN. We have an obligation to our allies in order to help complete the pipeline?

Mr. BRYEN. You didn't let me finish my answer, so let me finish it.

Senator KASTEN. I was confused.

Mr. BRYEN. I didn't mean that. What I mean is we have an obligation to help them resolve their energy problems to some extent, and I think that we are on that road now, that we have to look at the positive side, as well as the negative side here.

Their reasoning on the pipeline has been that they were searching for a source of natural gas and further energy and the Soviet's source was there. There was nothing else on the horizon that was all that promising in their view when they made these decisions in the late seventies.

There were also some optimistic projections on requirements at their end, that turned out to be a little too optimistic, that they don't require quite as much. There were some barriers in Europe to exploring, political barriers and economic barriers to exploiting some of the resources that they had.

We believe that we have some answers to that set of circumstances, and that properly presented it will help considerably in locating other sources of energy.

We also have some energy of our own we would like to sell.

Senator KASTEN. I want to get back to that.

We understand that Marc Leland has been in meetings, and I appreciate the fact that you are under a time constraint.

What we have been doing is for each to make a brief opening statement. As you know, Secretary Buckley defined what his mission wasn't, and unfortunately it was precisely what you and Mr. Hormats and others said it was going to be in the hearings we had in February.

That is when a number of questions were asked about the Polish debt and credits to the Soviet bloc countries and other issues. We said, well, we have to wait, the policy is in the process of being formulated, and one of the parts of that formulation is going to be the Buckley mission.

So what I would like you to do is address yourself to the question: If the Buckley mission was not the focal point for this consideration, the Polish debt and credits to the Soviet bloc, what is the focal point; where is it today; and will there be another mission that will deal with the problems that we are concerned about.

Then also if you could give us an analysis or a status report on the nature of the problem, as you view it.

In an opening statement I said that the problems of the Polish people are worse and not better today, and it is clear that our policy is still one of a lack of coordinated response, it is a weak response, and we still do not have the kind of coordination and the kind of cooperation that we would hope for from our European allies.

Also where are we in terms of the consideration of pulling the plug and of going forward and declaring the debt in default?

STATEMENT OF MARC LELAND, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. LELAND. I apologize for being late. These meetings were scheduled before we knew about the hearings.

In answer to the questions you have asked, first of all, I think there was a genuine misunderstanding on the focal point.

I went back and looked at the record from the hearing at which Bob Hormats and I testified. At the time we testified we didn't know there was going to be a Buckley mission. Bob is not here to defend himself.

But at that time you asked if there was going to be a high-level meeting in the next few weeks. I answered that as far as I knew there wasn't a formal meeting planned, and at that time there wasn't.

The problem was at that particular time, and I think as far as the Buckley mission went, that was an evolving process because of the kind of things that Secretary Buckley said in the brief statement, concerning what to do about credits to the Soviet Union.

Now, to talk about a focal point for all of one's relationships in East Europe is like talking about a focal point for foreign relations.

We have a multitude of interagency groups on different issues. You have the guru for Polish debt here, Ambassador Meissner. He goes to the meetings on official debt situations.

I am constantly monitoring what the private banks are doing. We are in daily contact, and there are numerous meetings to exchange general views.

Poland is one issue, and Romania has other kinds of problems, and Hungary is separate. There are many people in several agencies here who deal with the Eastern European economic problems, and that leaves out the whole political dimensions of these issues.

So what we said in our testimony there was that there are a continuous series of meetings. Larry Eagleberger meets with his counterparts and I meet with mine in Treasury. Secretary Regan is going over to the OECD in 2 weeks and will have meetings in Helsinki, where he will meet with his counterparts from the major countries, which are also the major creditors.

This will be a topic of conversation about the issues, and how it is handled, and how are the Europeans different from us.

As they put it, they followed our détenté example and then adopted it in spades, so to speak. They have not come to change their view to the same degree we have. We have to bring them to do that, and that is a part of the process of discussion with them. I think on that issue, I wouldn't want to say that there is going to be any one major focal point. Certainly it is a subject of conversation at the summit because of East-West relations in general.

As to your question about Poland, and our impact on Poland, this is the one that I think does come back to our original discussions. The question is, What gives you the most leverage over the Polish government, and what gives you the most hope that you can get them to change their present policies? What is going to pressure them the most?

Basically we all agree on our present policy of giving them the least amount of assistance or things to help them. That is, unless they reverse what happened in December 1981, they can't look for any help from us. We have had many meetings with our allies to get them to go as far as we possibly can on this issue.

Their views are different than ours. Thus they feel that their political decision to limit imports from the Soviet Union on nonessential imports, as done by the European community—even though in our terms it was economical—to them it was an enormous move. It showed, however, that they did recognize that something needed to be done, and

they were actually much more forthcoming than in the case of Afghanistan.

The Germans pointed out that they were the only ones we got to support us on the Olympics. Everyone else went and they became isolated, a situation which they didn't want, and they said, "We are only going to coordinate."

Now, with that preview on the Polish debt, we are back to the question of how do you maintain the maximum leverage? That is basically what we have continued doing. There is no new credit going to Poland from our banks or from any other source. No one wants to give credit to Poland. Interest payments came into the banks on 1981 maturities and now the banks are asking for the payments due in 1982. The Poles would like us to reschedule, but we are not going to reschedule at this point.

We are still owed money on 1981, and the pressure is to try to get them to come up with these funds, as it always has been, and to have whatever does happen, happen vis-a-vis Poland.

As to default, for example, this should be a coordinated action with our allies, so that there won't be a case of the situation being turned around—where instead of it being used by us as both politically and economically important, it would be used against us.

Senator KASTEN. Well, if we declared default, I think that that would start to unravel the system. The question is the strength of NATO and the damage it would cause within NATO by unilaterally declaring a default. But they would expect us to default, as you and I discussed, because of the agreement we reached with our allies almost a year ago today.

Mr. LELAND. This is where we disagree. If you could say that a declaration of default unilaterally by us would, as you put it, unravel the system, and some kind of credits that were going to them wouldn't go, or damage the Soviet Union, I would be in total agreement with you.

The problem is that a unilateral declaration by us of default is not seen by us, by bankers, or by anybody as something that would unravel anything. The Europeans would simply build up their own wall and they will say, "You took a political act, and it wasn't an economical act." The Poles, if they were going to pay any money, would say, "We won't pay you, but we will continue to pay the Europeans."

Whereas, if it is done as it properly would be, either they come up with a lot of hard currency, which is going to be difficult, or if they don't, on economic grounds the entire alliance declares them in default, so that really does affect their trade, and then their assets can be attached.

That would be effective, but it is our view that a unilateral declaration of default at this time would not have the unravelling effect you described.

Senator KASTEN. You have said here and in previous testimony that unilateral default would not be beneficial.

Or obviously you have said a default option is being discussed with our allies. What are the chances for a joint declaration of default?

Mr. LELAND. My feeling is you have two issues. One is default, and the other is whether or not you have a rescheduling.

I think that if the Poles do not come up with at least the interest that they owe the private banks, and to some extent the amounts that they owe on the official credits, you are not going to have that rescheduling. That amount of money you are talking about is several billion dollars.

If they come up with it, then it is a tremendous burden on them, much more burden than the impact of default. But if they don't come up with it, which is highly likely, then I think the possibility of coordinated action with our allies is very great, because then it is an economic question. The argument that we shouldn't declare default because they will stop paying anything won't hold up because they will not be paying very much anyway. Then you will get a coordinated action.

Senator KASTEN. So the default option is being discussed with our allies, and you believe that it is possible that we could, under certain circumstances, have a coordinated response?

Mr. LELAND. In the sense that one is constantly discussing with our allies whether or not we will reschedule; yes.

Senator KASTEN. It has been more than a month since talks were held with our allies on Soviet bloc debt to the West. According to press reports they agreed to a full exchange of information about financial credit to the Soviet Union in future consultations, with a view to hold a meeting, at which agreement would be reached on limitation of officially backed credit to the Soviet Union.

First of all, are the press reports accurate in terms of agreeing to a full exchange of information about financial credits?

Mr. LELAND. I would love to answer, but I think it wouldn't be appropriate. I think it would be fairer if Jim answered such questions.

Senator KASTEN. He has refused to answer questions to this committee on this subject, and the reason you are here is because we were told you would answer the questions.

Mr. LELAND. That I can't believe, because I can't answer. If he wants to answer them, I would be delighted. You know I would love to sit down and talk about them, but there would be no way that I could talk about them, and wouldn't. I don't think that that would be fair.

Senator KASTEN. At some point there has got to be someone in this administration, and I don't think we want to go through all of the mechanics that some of the House committees are going through right now with Secretary Watt, but there have to be some people in this administration who would be willing to stand up and discuss what a number of people in Congress think are critical issues.

What is happening is it is being deflected and spread around so that last night I had two people from the National Security Council calling saying how worried they were about what might happen in these hearings today if people started answering questions.

Well, we have a problem. Basically you say that you don't want to in any way discuss whether or not there is any agreement to a full exchange of information about financial credits to the Soviet Union?

Mr. LELAND. Senator, were you in closed hearing, I would be delighted to talk about anything. A lot of it, as you perfectly well know, finds its way into the press. The problem is that in any negotiating process, particularly when you are dealing with six or seven allies, any kind of official statement of what you are expecting results in that person saying, "That isn't what I said," and then hardening of positions.

Then the negotiations may be jeopardized. I think that is probably the reason why the representatives of the National Security Council called. There is no desire to keep anything secret. The problem is that as soon as an official position is put in that fashion here, the other governments must publicly react to it, and they have all got their internal problems and they are all democracies as well. As a result, you get pressures within governments to force them down to the lowest common denominator and that will make the negotiations impossible.

Senator KASTEN. I suggest to you that this information being leaked out by someone to the Washington Post or whatever on the terms of the State Department or Treasury Department is a lot worse than information coming out in a statement, and obviously agreement to full exchange of information about financial credits with a view toward holding a meeting at which agreement would be reached on a limitation of offically back credits.

These statements being leaked out are worse than a statement up front saying that this is where we are going, this is what we ought to do, and this is why.

As you are aware, one of the NATO diplomats, and you probably saw this same quote, stated there is a lack of information of what we are doing in this area and a lack of coordination. This NATO diplomat said the following: "There are no results to report unless it was Mr. Buckley's main purpose to learn more about the reasons why the Europeans do not feel the time is ripe for new restrictions against the Soviet Union."

Now that is a NATO diplomat. The lack of information shows there are no results. Is that the case, and are there no results?

Mr. LELAND. I think that is a provocative comment, and it would be a mistake for me to say exactly what I think. You can tell from reading that comment what the objective of that fellow is. If he puts it in that form and has us react to it, he knows there will be an impossible negotiating situation, which is what we are really trying to avoid.

Senator KASTEN. What I am concerned about is that I think there are people in our Government that would agree with the statement that the time is not ripe for any restrictions against the Soviet Union, and I disagree strongly with that; you may or may not.

Mr. LELAND. I do.

Senator KASTEN. If we push a little bit, I think the time is not only ripe, it is a tremendous opportunity. If we look at the hard currency problems the Soviet Union is having, we are at a moment where in the

next year or two we could make a major effort; and not only is the time ripe, I think the time is overripe.

I am going to ask two or three questions of you because I know you have time restrictions and ask you to stay as long as you can.

Our NATO allies are supplying the credits to build the Siberian natural gas pipeline, which will supply the Soviets with approximately $8 billion a year in hard currency.

One of our NATO allies, West Germany, has actually approved $117 million in new Soviet export credits since January.

What makes you think that our allies will agree to any meaningful limitations on Soviet credit at all, based on what they are doing right now?

Mr. LELAND. Any negotiations or discussions and so forth with allies are such that we know it is not necessarily an easy task. We have reversed a policy that went on for years. As I said, the lending that went on in the early seventies was first done by our Government, and they have followed. Their bureaucracies are such that it is going to take time and effort to turn them around.

I agree with your point, that the time is ripe, and we should do whatever we possibly can. And we are trying to do whatever we can to get success. The degree of success is always a question, but since the time is so ripe, I think we have a chance. But it is a long, hard process, and you won't have people who have been following a certain practice for several years and supporting it, all of a sudden from one day to the next change their view because of a presentation.

By working away at them, discussing it, and raising it to a higher political level, I think we have a chance, or I hope we have a chance, to do exactly what you say, to make it clear that the time is ripe, and we should grab this opportunity.

Senator KASTEN. My question is: What makes you think our allies will agree to any meaningful limitations on Soviet credit at all?

I understand the time is ripe, and I understand we are having negotiations, but everything, including the $117 million in new Soviet export credits since January from West Germany, indicates that our allies are not, will not, or are not willing to agree to meaningful limitations. What specifically makes you think that our allies will agree to it?

Mr. LELAND. Because they are allies, and I think it is a process. We have done things that they have had us change after discussing it.

They are doing things that our Government doesn't like, and we are doing things that they don't like. But with allies you try to bring them around to a position.

As I said, right now if I just went in and made my most impassioned speech, it wouldn't do it. But maybe if the President of the United States does at various points and the Secretary of State does, and the Secretary of Treasury does, and the importance to the United States is made clear, and there are other issues on which there may be things that we may not want to do, but might be willing to do because they are willing to come along on this; it is a matter of negotiation.

When they made those loans that tradeoff did not exist; our aim is to grab that opportunity, just as you said.

Senator KASTEN. I suggest that unilaterally declaring default would be one more thing on that list which might get their attention, but they can disagree.

Polish officials state that they cannot make the payments on their debts to the West unless we extend them additional credits. Yet, the NATO allies agreed in January that no future credits would be extended to Poland until martial law is lifted, political detainees are released and talks are resumed between U.S. officials and the Solidarity Union group.

Can Poland make its payments on loans to the West without additional credits?

Mr. LELAND. They have said, "No." But the question of what Poland can do depends upon how much the Soviet Union can be called upon, or the other satellites, to do for them. Basically looking at their own economy and what they produce, and nothing else, the answer would probably be, "No."

What their potential exports are, and what they can call on the others for is hard to know. So from that standpoint, I can only answer the question by saying that we will have to wait and see. If they don't pay they will have to suffer the consequences.

PAYMENTS TO POLAND

Senator KASTEN. Mr. Meissner, can Poland make its payments to the West without additional credits?

Mr. MEISSNER. What the Poles are saying is that they are dependent upon imports from the West for economic growth. Two-thirds of their industry is dependent upon spare parts or raw materials from the West. Their agriculture has become dependent upon the West both for machinery and certain types of fertilizers and for feed grains. That is just to save their livestock industry.

What they are saying is if we don't provide credits which help them sustain their productive capacity, not having that productive capacity they can't export and pay us back.

Assuming their projections of their gross national product; yes, they need credits. Assuming that the level of living of the Polish people is significantly reduced, they may not need credits.

As Marc has said, it also depends upon how much is supplied in excess resources to them from the East bloc countries.

Their argument is based upon a perceived per capita income and standard of living—which they have to propose for their own political survival.

Senator KASTEN. Do you believe the West should extend additional credits to Poland?

Mr. MEISSNER. Not at this time.

Senator KASTEN. Mr. Leland, do you believe the West should extend additional credits to Poland?

Mr. LELAND. No.

Senator KASTEN. In February when Romania fell behind by $5.8 million in payments to the U.S. Government, we demanded that they pay up immediately, and they did. My understanding is that there was a difference of opinion and at one time there was a recommendation from at least one of the Departments of the Government to treat Romania the same way we treated Poland, and to put them in the CCC financing system.

Is that correct?

Mr. LELAND. Treat them, what?

Senator KASTEN. We said we would not bail out the Romanians, and in the case of Poland we said we would. My understanding is that there were recommendations to the administration that we treat Romania the same way we treated Poland.

Mr. LELAND. I think it is a bit of a difficult question, because Poland didn't have any resources to pay, and wasn't paying, and the banks hadn't been paid.

The banks weren't bailed out. We were the guarantors, so when the prime debtor didn't pay, we paid the debt to the bank.

In the case of Romania, they were just late in their payments on loans guaranteed by CCC. Therefore, we reminded the Romanians, of their obligation, and they did pay.

If we had not been able to get it from the Romanians, we would have had to pay the banks.

ROMANIAN PAYMENTS

Senator KASTEN. Has Romania been making its payments since then?

Mr. LELAND. Some. They have been making their payments to CCC. However, the Romanians are trying at the moment to work out a rescheduling of their debt, and it is tied up with the fact of the IMF program which was started and delayed. There shouldn't be a rescheduling of their official debt until they can reach agreement with the IMF on a standby program. Meanwhile, they have been making some payments to their private creditors, but not all that is due.

Senator KASTEN. Do you want to respond to that as well, Mr. Meissner?

Mr. MEISSNER. The Romanians have made a major effort to pay direct credits that have been extended from the United States. We are talking about CCC credits, and I understand they presently are current in their CCC payments.

Where they aren't current is on credits that were either insured or guaranteed by the Export-Import Bank where they have not made payments to the banks and the banks have subsequently asked for reimbursement from Ex-Im on the basis of the insurance, where the debt is guaranteed. In terms of the notes that have been provided to me, they are in arrears of $2.4 million in Ex-Im.

Mr. LELAND. And they are paying the banks.

Mr. MEISSNER. They are paying Ex-Im and the banks the same percentage. What happens here is that they have been in negotiation with

the private banks and they have an agreement, apparently on an informal basis, with the private banks that they will attempt to make a payment of 20 percent of their principal and interest during the period until they get a debt rescheduling.

As a result, there are banks in the United States that only have received 20 percent of their payments. To the extent that they have been either insured or guaranteed by Ex-Im, Ex-Im has been asked to make up the full payment to the bank.

So that is how that has come about.

ATTITUDES OF BANKS IN THE UNITED STATES

Senator KASTEN. This morning the Wall Street Journal said six commercial banks, betting that Poland will eventually pay amounts of the debt outstanding, spurred a U.S. Government offer to reimburse them for part of the interest on the loans.

How has this developed, and what is the significance of this?

Mr. LELAND. I am about to confer on them the optimist of the year award. The significance is that the banks had certain options, and their feeling is that they would have a better option which would allow them to get what we owed them, including 6-percent interest. But if we paid the 6-percent interest there was a provision regarding how the Polish funds, if they came in, would be allocated between the banks and the Government.

So they preferred, and it is their call, to try to get all the interest themselves because they thought they had a better chance to get it. That is the option that they took on the payments presently owed.

Senator KASTEN. Mr. Meissner, do you want to respond to that?

Mr. MEISSNER. This applies to the CCC arrangements and the offers, options offered by the U.S. Government under directions of the CCC. There were two options laid out, which Marc has outlined. The banks have their choice whether they wish to take their guarantee or whether they wish to in essence go into a pool with the U.S. Government where we would pay them their guarantee and then some percentage of whatever as a group we can collect of the interest due.

The six banks are saying, "No, we would rather not be in a pool arrangement, we will go out and try to collect our interest ourselves."

Senator KASTEN. Is there any way that you could interpret this as a suggestion that we would, in fact, be providing Poland with more credits? Therefore the debt situation would be eased, and they would be able to collect their money on their own? There was no deal made with these banks?

Mr. MEISSNER. There is no deal between us, but the banks may have in mind that they might be personally able to extend credit to Poland, and therefore get the Poles to pay them first. But I have no idea if that is what they have in mind.

Senator KASTEN. You don't know if that is the case, but you can agree that that could possibly be the case and some commercial banks may be dealing directly with some Polish financial officials?

Mr. MEISSNER. Not officials, but they would be dealing with the Polish government, and they may be looking ahead to say, "Well, OK, we have country limits now, but in 2 years things may improve, and we would be willing to possibly extend credit to 2 years and the condition on extending that credit would be that all past interest due is paid to our bank."

They then get their past interest paid, possibly earlier than the U.S. Government or anybody else would.

I don't know any rational U.S. banks which would be extending credit right now to Poland.

RECOVERY OF POLISH ECONOMY

Senator KASTEN. I agree with what Marc said about the optimism, and I was surprised at that. I was trying to figure that out, and I didn't understand.

Mr. MEISSNER. It may be just a judgment on recovery of the Polish economy.

Senator KASTEN. Which recovery could be dependent upon additional credits coming from somewhere, that may be from the Soviet Union, but it may be from Western countries?

Mr. MEISSNER. That is correct.

Senator KASTEN. That is my concern.

Mr. LELAND. We all share that concern.

Senator KASTEN. Particularly NATO countries. But that the economy could be shored up, particularly by the West Germans, and the pressure would be on the banks, and there is going to be some pressure there.

With reference to the Wall Street Jounal story, the banks chose to forgo the 6-percent interest payments and tried to get the entire interest payments. If they do not succeed can they come back later and get the 6 percent?

Mr. MEISSNER. As I understand, they would not be able to.

Senator KASTEN. Someone is shaking his head behind you. So they are not taking a gamble?

Mr. LELAND. At a later date they can come back and get it and I think there is an ability, and I think the issue was they did not want to be bound by anything, the banks did not want to be bound by a rescheduling made for them by the Government.

I think the U.S. Government is not free of that obligation.

[CLERK'S NOTE.—The following is a clarification of the previous answer:]

No; for each payment, the banks have to tell CCC whether they choose to receive the 6-percent guaranteed interest in addition to principal or principal only, with the right to collect all interest—both the 6-percent guaranteed interest and the remaining unguaranteed interest—from Poland, If the banks choose the latter option and are unsuccessful in obtaining payment from Poland, the banks are not entitled to collect any interest from CCC with respect to that payment.

Senator KASTEN. It is only interest and not the principal?

Mr. LELAND. Yes.

Senator KASTEN. We have disagreement.

Mr. MEISSNER. That is best discussed by the Agriculture Department.

Mr. LELAND. I tried to get an answer on that, and on your question, Senator, about new credits. I think the issue here is going to be, as Chuck said, that no bank is really going to be making credits. But what may happen and no American bank has done it yet as far as we know, is that they may lend the Poles money if they think that they can give 50 cents to get back $1. That is normal banking practice.

When they have a distress situation, you feel that if you keep it alive—and as long as you can make sure that the flow to you is larger than the flow to them, but you are providing the credit—that is the way to operate.

Senator KASTEN. You can argue that is how we got to where we are right now.

Mr. LELAND. We got to where we are now by the opposite approach, by not doing that, and by letting the flow go West to East. I think we can safely say, that any banker who would put himself in a situation of increasing Poland's debt obligation to his bank, wouldn't be in business very long, or have his job very long.

SOURCES OF FUNDS FOR POLAND

Senator KASTEN. Do you have any information about how Poland came up with the $500 million in interest payments necessary to allow this April debt rescheduling to go through? Where did they get the money?

Mr. MEISSNER. The Poles are continuing to export primarily raw materials to the West, and their exports run on an average of about $500 million a month. It is our understanding that they so staged their imports from the West, which they are still continuing to import and to run a surplus on the trade account.

On the savings of that surplus, they were able to accumulate foreign exchange to pay the banks.

DECLARATION OF DEFAULT

Senator KASTEN. The State Department has continued to make the argument that the best way to put pressure on Poland has been not to declare them in default so they have to continue to cough up interest payments each time.

If this is true, why is Poland trying so desperately to avoid default? If that is the best way that we can exert pressure on them, why are they working so hard to avoid default?

Mr. MEISSNER. First of all, I think it is not a State Department position. It is a U.S. Government position. Certainly that of the executive branch, but I would assume that it represents the congressional position, though there may be differences.

Second, I think that what we are trying to do in Poland is to recover our assets to the best of our ability, and at the same time leave the Poles in a situation where we continue to have leverage.

Now it is true that the Poles don't want to be in an official default situation, and I think we, possibly for different reasons, have the same objective. We wish to be in a position where we want them to pay and continue to pay as much as we can pressure them to pay and as Marc said, get a flow of resources to the West.

It is a short-term issue of getting paid now and recovering as much U.S. taxpayer money as we can, and absorbing as much as possible of the foreign exchange that they would otherwise use for Western imports.

The Poles, and I can only have a subjective guess, are saying that if they get into a default situation formally and officially——

If I can continue, I think the Poles are looking for longer term economic relationships with the West. If they are in a default situation, they believe that their commercial relationships will be more difficult to recover, and I think they are looking toward this issue of new credits up front. They believe that they might be able to get new credits up front if there weren't a legal default situation in the West against them.

The realities are, as far as we are concerned, that they are not getting credits now, so while both sides may be saying they don't want a default, I think that the reasoning behind the positions may be quite different. That is why, although there initially seems to be an anomaly, if one reasons through the argumentation, both sides are fulfilling their objectives, but for different reasons.

I think primarily it is a timeframe. It is a hope by the Poles for new credits which I don't think is going to be fulfilled because I don't think those credits will be forthcoming.

POLISH AVOIDANCE OF DEFAULT

Senator KASTEN. The second part of my question was: Why is Poland trying so desperately to avoid default? Isn't it because interest payments are a small price to pay to keep Western financial institutions interested in Poland's future, to maintain the illusion of Polish credit-worthiness, and to keep the door open to future Western credits?

Essentially you said, "Yes," that that is the point.

Mr. MEISSNER. That is a much longer term view than our own. I think the Poles are looking much further out than we are. Now, therefore, I think you have this anomaly which I can be reasonably certain of.

Senator KASTEN. I don't agree with all of your reasons, but I understand what you said.

Mr. LELAND. It isn't just credit, it is also trade. They are in a situation where they want to show that they are making a good faith effort to pay as much as they can, and the issue is how much is that. Therefore, they are trying to pay and continue to have trade with us.

They are talking to the Europeans, and we are a great superpower, but the big players in this are our allies. It is the same way that we are the big players in our hemisphere. The debt burden and the trade issue is theirs, and we are very little in it.

As to the debt of our banks and our trade, we went into Poland with CCC credits in a fairly big way in the last 1½ years before martial law for political reasons, at a time when it looked like they were liberalizing. But other than that our financial stake is not large. Therefore what the Poles want to do is to keep the Europeans convinced that they are making a good faith effort and they are paying.

Now, they would like to get off the hook altogether by saying, "But those nasty Americans created this by taking political advantage. If it hadn't been Poland but rather some other country, if we were paying this amount of money, we would not have been declared in default. So it is a political default, not an economic one, and you should go on trading with us."

Now it goes back to the basic issue. That issue is how do you get your allies to agree with you, and to do that is a question of how you let the situation evolve. Interest is a small amount to pay, as you mentioned, but the amount you are talking about is over $3.5 billion this year. If they paid that in order to maintain their credit, that would be a pretty large amount to pay, given the fact that even prior to martial law they were talking about needing then up to $10 billion just to meet their debt service.

So it isn't a small amount. What they are trying to do is maintain with the Europeans the idea of good faith. I think it is going to be very difficult and if they raise the cash, it will have to come from other sources.

Senator KASTEN. It is frustrating to us in Congress and to me personally—that the basic issue is much more basic than that you just mentioned. The basic issue is the martial law in Poland and the basic issue is the freedom of the Polish people.

The basic issue is the people who are now in jail and being detained. The basic issue is that our Government ought to be more concerned about exerting the maximum pressure on that government to remove martial law, to reestablish the communication between the church and the government, and to give these groups of people the freedom for which they have so strongly been struggling. That is the basic issue.

Mr. LELAND. I agree with everything you said; that is the basic issue. The only thing we don't agree on is how you maintain the maximum pressure. The fact is that the maximum pressure that the United States can exert is limited, given that the chips we have in the game are considerably less than those of the Europeans.

So our job is to get that maximum pressure to be exerted by them as well as by us. We feel that the approach that we are following, and it has administrationwide support, is the correct one. Maximum pressure for the time being is by operating this way because that allows us to maintain the maximum leverage for our allies.

A unilateral action by us to go 100 miles would be far less effective in this region than a multilateral action to go 1 mile.

Senator KASTEN. I understand you. That is where we disagree. At a March 18 meeting of the so-called Paris Club, which I understand is an ad hoc gathering of official creditors of the countries whose debts are

being rescheduled, a written Polish request to begin new talks on rescheduling the $10 billion due to the West in 1982 was rejected on the grounds that little had changed politically in Poland since the imposition of martial law.

Is that assessment still accurate?

Mr. MEISSNER. Yes; that assessment is still accurate.

Senator KASTEN. Nothing has changed since the imposition of martial law?

Mr. MEISSNER. Yes.

DISCUSSIONS WITH ALLIES

Senator KASTEN. I am concerned that the Buckley mission was addressed only on future credits and only Government credits to the Soviet Union.

Is there an effort being made to discuss credits to the Soviet bloc countries, and not simply the Soviet Union, and is there an effort being made to work with the licensees and others, and is there an effort being made to discuss the credits that are not Government related?

Mr. MEISSNER. There is no effort presently by the U.S. Government diplomatically to discuss with our allies straight commercial relationships, with the exception of the COMECON regulations, which are an agreement between our allies on the type of technology and products we are willing or not willing to sell to the Soviet Union or to any of the Warsaw Pact countries.

On the issue of credits, the only places on which we have discussed placing restrictions or sanctions on credits have been Poland and the Soviet Union. We have discussed, as Secretary Buckley has said, the issue once again only in terms of official guarantees or direct loans.

Senator KASTEN. To the Soviet Union and not to the Soviet bloc?

Mr. MEISSNER. And not to the other Warsaw Pact countries.

ECONOMIC ROLE OF THE SOVIET UNION

Senator KASTEN. One of the things I am going to discuss with Mr. Bryen is the fact that by aiding the Warsaw Pact countries or by providing them with credits and financing, we are relieving the Soviet Union of that responsibility, thereby making their resources or their hard currency available for use in this unprecedented offensive military buildup.

That is a link that seems to be missing from these negotiations, if we are talking only about credits to the Soviet Union. We are talking about credits to the Warsaw bloc countries as well.

Mr. MEISSNER. I understand your point of view.

Senator KASTEN. Do you disagree with that assessment?

Mr. MEISSNER. I agree that there is interdependence in the COMECON countries, in the East bloc, and since all financial resources are fungible, certain arguments can be made.

The question, I think, is the significance of that contribution and whether the Soviets would actually "come to the aid" of their satellite countries, which implies some sort of umbrella theory, associated with hard currency. We haven't seen the umbrella theory function vis-a-vis Poland, Romania, or Hungary.

With respect to hard currency, I don't know if it is true. There have been some substitution effects, I would say, because the Soviets have found it in their interest to increase supplies of raw material and possibly energy to Poland which it would have purchased, possibly from the West.

The Soviet trade deficit to Poland will probably be higher this year than anticipated which means that they are actually shipping in materials, but they are not providing hard currency.

Senator KASTEN. They don't have all of the hard currency to provide?

Mr. MEISSNER. To the extent that your argument is based on the idea that it would save hard currency for the Russians, it is only true to the extent that they could sell those raw materials abroad, let us say, and turn them into hard currency, but the Soviets are not providing hard currency to the East bloc countries. That is for payments to the West where you would get a direct substitution.

ECONOMIC COMECON

Senator KASTEN. One of the ideas that I have been considering is the arrangement you mentioned on technology with the COMECON.

Why couldn't we use that basic model and convert it to credits to financing and to overall financial policy toward the Soviet Union and the Eastern bloc countries?

In other words, under those basic ideas, we look at the exposure and we decide what is in our overall best interests. In the case of energy, could we instead of working with the pipeline, use Norwegian gas or guarantee that the coal would be there when they needed it?

Why can't we put together a financial trading credit organization like that?

Mr. MEISSNER. Well, I think in theory it might be possible, but as I have mentioned in response to your last question, money is fungible and it moves very easily. You would find that you would have to include in your net of agreed-upon countries, people like the Cayman Islands and the Netherlands Antilles and Singapore, and the money would move ahead of you as new countries develop the banking capability with Eastern Europe.

We have a very difficult time controlling the flow of funds except as they may go through or be guaranteed by a central government. So that while in theory I think the possibility exists, it would be exceedingly difficult to put it in place in terms of international banking practices because of the shell-bank system that is already operating in the international financial markets.

SOVIET USE OF TRANSFERABLE RUBLE

Senator KASTEN. You said that in terms of hard currency being transferred from the Soviet Union to Poland, et cetera, that wasn't going on now. In the Wall Street Journal Mr. Nagorsky talked about a transferable ruble. By using that mechanism, the Soviets were able to obtain favorable exchange rates from COMECON partners, and thus buy manufactured goods cheaply.

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Do you disgree with his analysis?

Mr. MEISSNER. I don't know the specific analysis or article, but within the Soviet bloc countries or in the COMECON system, you have what is described or known as the transferable ruble, and it does function as a currency within the COMECON countries.

It sounds like he is arguing that the prices, or the terms of trade as specified in transferable rubles are loaded against the Eastern European countries.

Senator KASTEN. That was his thesis.

Mr. MEISSNER. And, therefore, since you have in essence barter-trade, you can set prices in such a way that there is actually a flow of resources from Eastern Europe into the Soviet Union. The transferable ruble is not a hard currency ruble. It is only good as an accounting device and pricing device internally to the COMECON bloc.

It may be true that the prices are set in this manner, but we also know that the Russians do not have a pricing system and in fact none of the Eastern bloc countries have any way to judge relative prices, so they use the prices that are available for similar goods on the free market.

They make the assumption that the quality and the services and the capability of the products are roughly equivalent, which is not true, because we know that Eastern Europe cannot sell many of their industrial products to the West because they are not comparable to what can be produced in the West.

It can be argued on the first point that what the Soviets are buying in terms of manufactured goods are actually priced higher than the comparable goods in the West.

Second, the Soviets in terms of selling raw materials to Eastern Europe, which is what they primarily do—they are raw material suppliers to an industrial sector in Eastern Europe—also follow roughly the same system of trying to price their raw materials on the basis of the cost of raw materials in the Western market system.

There is a lag effect of from 2 to 4 years in terms of readjusting the prices. So once again it is possible to counter the argument that is laid out in the Wall Street Journal that the lag effect is such that the Soviets, in terms of Western market prices, are actually subsidizing the Eastern countries in terms of cheaper resources.

This is especially true on energy, which as we all know has rapidly risen in the West, but there has been a very low rise in the price of energy that the Soviets are selling Eastern Europe. The lag may be as much as 4 to 5 years.

The Soviets now are attempting to raise the price of energy internally within the COMECON countries, and they are having a difficult time doing it because of the resistance of their allies within the Warsaw Pact, who don't wish to pay international energy prices for Soviet gas and oil.

So while the thesis, I think, has an economic base and is arguable, it also can be argued from the other side that the Soviets are involved in sustaining an empire in an imperialistic way, and it is costing them money and you can argue that they aren't breaking even on it.

I would have to look at the article and get an analysis of it or we can try to get an analysis of it for you, but it is certainly possible to argue it the other way. We have the same types of arguments vis-a-vis the French empire or the British empire.

Was it a drain on the British economy or did it help the British economy, and those arguments have gone on for 50 or 100 years, all on the same basis of how much money was invested and how much money was lost, and how much trade and how much technology and so on.

It is very difficult to price out the value of an empire.

Senator KASTEN. I discussed this issue at length with Fred Ikle in terms of the resources, and it is my impression that they were under the strong feeling that by aiding or applying credits to Poland, that we are in effect allowing the Soviets to carry on this unprecedented offensive military buildup.

Is that the position that you still maintain?

Mr. BRYEN. Yes.

Senator KASTEN. Could you describe that briefly?

Mr. BRYEN. Quite simply the more the Soviets are burdened with everything to support Poland economically, the more they have to draw it out of some part of their economy. The presumption is if they themselves are close to the wire in terms of their own economy, or the balance of their economy, that they have limited hard currency, which we talked about this morning.

They themselves are trying to borrow money in the West to import the products that they need, and if there is a burden added it would probably mean that they would have to take some steps either to reduce their military expenditures or reduce the standard of living, or both.

Reducing the standard of living is a risky business these days.

Senator KASTEN. We have been talking with our allies for several months now, months in which the plight of the Polish people has been allowed to fade, I am afraid, from the public view. As a matter of fact, I think the cries of outrage have died off faster than they did in the case of Afghanistan.

Since we have not persuaded our allies to join us in some tough sanctions, isn't it about time for the United States to go ahead on its own without the allies?

Mr. BRYEN. Well, I think the problem of going ahead on our own always is a question of whether there is not a one-to-one substitute elsewhere for what you might otherwise supply.

The problem in sanctions is you need allied cooperation in most cases to make them effective. We have been faced with this problem all of the time, the desire on our part to assure that the sanctions we have and the commitments that we have gotten to, to not undermine them, and they are basically honored.

That would go a long way in helping to make the political point, not only to the Poles, but to the Soviets, that we are indeed serious about this.

Mr. BRYEN. I would like to submit a paper on that. That is a very complicated question, and I don't think that the answer is going to do me any good or you any good. I think there is a sense on our part that there is some economic leverage, and we have some economic leverage, and it is a way of getting a message across loud and clear if we do it in a coordinated way.

One doesn't like to see these things undermined, and it takes a certain considerable persistence on our part. It doesn't matter which administration does this type of thing, but it requires a great deal of persistence not only to initiate a coordinated approach to these kinds of problems, but to sustain it. If you don't sustain it, then it doesn't have any great effect.

Senator KASTEN. What I would like you to comment on, is that the role of the NATO alliance in influencing the U.S. reaction to these different crises.

In my mind it is a very different one. On the one hand NATO was encouraging us in the case of Czechoslovakia to take strong steps, and this time it seems to me that it is the NATO alliance that is holding us back.

Why aren't we taking stronger action? Is it because we are concerned about the allies, and we are concerned about the fragility of NATO? Is my view wrong, that we are being held back by our European allies in one respect and being pushed forward by them in another?

Mr. BRYEN. I am pausing for a good reason on trying to answer that question. I think there is a difference after all in the Polish case. I don't personally regard it as a great difference, but there is a difference nonetheless, and that is that it was an internal situation and there was no actual Soviet invasion. That may have had some impact on the alliance.

Senator KASTEN. Had the troops come across the border with tanks, that would have made the difference?

Mr. BRYEN. I personally think the result is the same and the Soviets were heavily involved, but you have to convince the others. It is an alliance made up of countries that have different views on these matters, and you have to convince them of it.

Senator KASTEN. Well, you and I both know that you are talking around it. Your office has been most concerned with the technology transfer.

Mr. BRYEN. That is correct.

Senator KASTEN. Legal and illegal?

Mr. BRYEN. Yes.

Senator KASTEN. To the Eastern bloc and the Soviet Union?

Mr. BRYEN. That is right.

Senator KASTEN. How would you characterize the effect of our past trade policies, the so-called hoops of gold concept? In terms of the hoops of gold concept, how would you characterize the effects of past policies on keeping sensitive technology away from the Eastern bloc and the Soviet Union?

Mr. BRYEN. I think until this administration came in, it was a net disaster. That is to say that very sensitive technology across the board in

just about every category you can think of was transfered to both the Soviet Union and the Eastern bloc. It has done great harm to us, and we are playing catchup ball now trying to adjust to the situation.

It is very difficult to do. Again, you can't any longer hope to do it unilaterally. Times have changed, and the technology is a sensitive topic and has spread around the globe. Nonetheless I think we are making some very considerable progress through COMECON, through NATO, and in bilateral discussions so that I have some cause for optimism that we can arrest the trend.

I want to stress that this is not a 6-month or a 1-year deal. We have to persist with this at least for a decade if we are going to be able to trace and understand the full impact of our actions to get real results. I think the results are achievable, and I must say that we are getting on the whole the cooperation in the effort from our allies and friends in Japan and NATO countries. So there is reason to believe that we will succeed.

ECONOMIC CONTROLS

Senator KASTEN. Could I ask Mr. Meissner if we couldn't set up a financial group along with the COMECON model?

Mr. BRYEN. I think Chuck has pointed to some technical problems that would have to be overcome to do that. In principle, or more than in principle, we do need a mechanism, and I think Senator Buckley in his prepared statement talked about it, and whether it is a COMECON model.

The COMECON model has some problems that you might like to know about. It is a voluntary organization and it works on a consensus. Every member has to agree, and it didn't perform brilliantly in the last decade. If it had we would not have had the problems we have now, and so there are many problems with the model. But a mechanism that included not only the alliance, but Japan and some other supplier countries would go a long way to treating this broad issue, this broad problem, in one forum.

There are an awful lot of forums right now. That is one of the problems we have.

Senator KASTEN. I agree with you. That is one of the problems we have. You line up 10 different people and you still don't have a focus. I don't know whether it should be in the National Security Council or not.

Mr. MEISSNER. There are two questions you are raising there, Senator. One is, do we have a focus in dealing with what you may call for economic policy toward the Warsaw Pact countries in terms of dealing with our allies? No, we don't. We have numerous forums across the spectrum of issues and across a spectrum of institutions.

The second question, I think, which you just alluded to now, is where in the administration is the formulation of policies centered? Yes, it is in the National Security Council system and in the senior interagency groups that function under the National Security Council. There is a senior interagency group on East-West policy.

Mr. BRYEN. We are speaking to the problem. That is on the Washington side of the problem.

Senator KASTEN. Mr. Denysyk, in the testimony before our subcommittee, a number of Polish experts have stated that the Western credits supplied to Poland have simply served to shore up its inefficient economy and to keep absolutely essential and fundamental economic reforms, the kind of reforms that would be necessary to permanently raise the standard of living for the Polish people, from taking place.

What we are witnessing today is not the bankruptcy of Poland, it is a failure of the Soviet economic system. This is one of the reasons why Solidarity leaders support a cutoff of credit to the East, and a default on the Polish debt.

Now, when you go beyond the Western financial perspective and consider the economic future of the Eastern bloc countries, I happen to think that their argument is a persuasive one, that what we are seeing is a failure of the system, as we define it, and we are forestalling the collapse—or as everyone has suggested, it is a tough time to lower standards of living. Even in a totalitarian system there are going to be pressures created.

I think that this argument is a persuasive one, and I wanted to know if you would like to comment on this question.

Mr. BRYEN. Well, I don't think anyone in the administration is arguing that the Polish or Hungarian model is something we want to pursue. I might add that each country's experience in Eastern Europe is somewhat different. Hungary, for example, has some different experiences and some joint ventures and so forth, and Romania has perhaps more so.

Poland has other aspects, but I think as a general statement I would agree that the economic system in Eastern Europe and the Soviet Union as a general proposition is not the ideal one.

Now, whether supplying credits to it helps or undermines it or is counter to our policy, I think it is a very complicated one. It is not as easy to address as I think some Solidarity leaders would like it to be. There are financial flows, being what they are, and we still feel the best way to put pressure on a system is to keep it as we are doing in Poland.

In Hungary we are taking a different tack, to keep the pressure on those governments to reverse the flow of funds that occurred over the past 10 years.

Senator KASTEN. In a question to Mr. Byren, we discussed the past policies of détente. A number of experts have testified before us in the past several months to the effect that this decade of détente has been more beneficial to the Soviet Union than it has been to the West. The trade that was intended to insure good behavior on the part of the Soviets and bind the East to the West, with the so-called hoops of gold, seems to have bound our own hands instead.

Could you comment on the benefits of the détente to the East and the West and the degree to which you would agree that we have bound our own hands instead.

Mr. DENYSYK. I haven't heard the analogy of hoops of gold, and I prefer to call it that you are throwing small strings over a guy at a time when he can't move. Personally I never subscribed to that theory and I still don't.

I think the Soviets use détente in a tactical way as opposed to a strategic sense, which I believe the Western countries and ourselves did back in the early seventies and the mid-seventies.

In my opinion they did use it to their advantage, and they built up their military forces in an unprecedented scale, and they were delivering out technology.

I might add it is easy to point fingers, and I think we should point fingers at ourselves also. We as a government were encouraging all of that, through all kinds of mechanisms, scientific exchanges, and sales and commissions, and so forth and so on, and the Soviets received it.

This administration has seen it a bit differently and will continue to see it differently. We need to look at relations with the Soviet Union in a very realistic and pragmatic way of what is to our benefit in our relations.

To look at the transfer of these things, it doesn't support this. Look at the credit issues. Why should they be getting a free ride or why should they be getting concessional terms? So the issues in my opinion are being addressed in a realistic way, and not in the light of détente.

I might add what I mentioned before, why aren't our allies coming along, and there are a couple of points I would like to make on that.

The first is to some extent we have a situation like a large oceanliner or a ship that is loaded with oil, and it has gone on and the momentum that it has is enormous. It takes miles and miles of open ocean to stop a ship and reverse the direction. I think over time we will make our arguments and make them over and over again. And in time the direction will be changed. I am very hopeful, as Marc was, that the direction can be changed.

In the spirit of specific actions of today or tomorrow, I submit to you that we are not the fount of all wisdom on what is the best way to approach this, with sanctions, or what should be done. I would prefer to see a coordinated effort among the various allies and Japan, instead of the United States coming out in front.

Perhaps it is politically convenient for U.S. politics to do that, but I will submit to you in terms of having a real effect it would be minimal, compared to what could be done in a coordinated fashion.

In international negotiations it will take much more time. I come from the private sector, and I like to think in terms of short timeframes of getting things done. In the bureaucracies it takes a bit longer, and in the U.S. bureaucracy it takes much longer, and international forums it takes much longer.

Again I am hopeful, but I would suggest that some time be given in the administration to accomplish some of the things that we set about doing.

I will get off my soap box now.

IMPACT OF DÉTENTE

Senator KASTEN. It is my view that our lack of a straightforward policy on the Polish debt is a hangover from the late seventies, and that the same kind of decisions that were being made then. I think the fact that the President chose not to bail out Romania is simply an indication of this.

As you pointed out, we are treating Romania differently and the fact that they are being treated differently, I think, is significant.

Mr. MEISSNER. I think your general analysis has accepted that détenté in terms of global strategy didn't work, but I think the Europeans felt that as Marc said, it worked very well on a regional basis for the Europeans within Europe.

It is very possible that without détente, without the capability of developing a differentiated policy in Eastern Europe—as we still have—that Solidarity would never have arisen and the per capita income of Poland would never have gotten to the point that when it began to drop dissatisfaction was registered countrywide.

One of the great problems was that the Poles lived on external credit in the 1970's and their per capita income did rise. The mere fact that they got in a bind and the per capita income began to fall was one of the things that pulled the national consensus together to support Solidarity.

It can be argued both ways. I think it is much more effective to argue it vis-a-vis the Soviet Union and the Soviet Union's capabiity. But in evaluating détente and differentiation policies vis-a-vis Eastern Europe is a different equation, and the Europeans look at it as a different equation.

That is why I think our emphasis has been on credits to the Soviet Union and on relationships to the Soviet Union, and there are the linkages—there is no doubt about it—with Eastern European economies. But our capability to tactically separate the Eastern European countries in terms of their foreign policy and their economic policy, and their military policy vis-a-vis the Warsaw Pact, to a certain degree depends upon the ties that the Europeans have with Eastern Europe, and on the economic linkages that allow the Eastern European countries to have at least more mobility in terms of their domestic economic policy and, we hope, more mobility in terms of their defense policies than they would have otherwise if they were totally isolated into a homogenous bloc with the Soviet Union.

Senator KASTEN. I agree with you that from time to time the Government takes a long time and international negotiations take even longer, but it didn't take our allies too long to line up behind Britain in the Falkland Islands crisis. There are times of emergency in which you put aside these negotiations and just simply go forward.

I would suggest that there were differences between the response of NATO in the three different examples that I addressed to Mr. Bryen, and we have seen examples. The Falkland Islands happens to be the most recent incident in which there was a concerted effort and there was a unified, solid response made. That response was a lot different

than the response that we are seeing in the question of the imposition of martial law in Poland.

Mr. DENYSYK. Could I make a comment on that, not to be argumentative, but I would submit that some of the actions taken by our allies and ourselves for that matter as to Poland, perhaps different things would be done in different countries, but there were things done.

The EC did limit imports, perhaps not as much as we would like, but there was an unprecedented move on the part of the EC. There was a unit to criticize trade, and it was a step forward.

Now, perhaps one looking from a broader perspective would say the step wasn't large enough, and that is arguable.

So just frankly, there have been 5 months past since December 13, the fateful day, and we still have some pressure going on and discussions going on on a whole host of issues. So I submit that progress is being made and perhaps it is not as bleak as some would paint the picture.

Senator KASTEN. I think it is bleak, and it is disturbing, and this committee is going to do everything that it can to put pressure on the various bureaucracies. I think progress is going to be putting more and more pressure on the executive branch in general on this issue because it is clear to me that the American people view our response to this crisis as very inadequate.

CONCLUSION OF HEARINGS

I would like to thank you all for participating today. This will conclude the hearings on the Polish debt crisis.

There is a possibility that we may submit further questions and other Senators who have not been able to be here may submit questions for the record, and we will get those questions to you and hope you can respond to us in a timely manner.

Once more, thank you for your participation this morning.

[Whereupon, at 11:50 a.m., Wednesday, April 21, the hearings were concluded, and the subcommittee was recessed, to reconvene at the call of the Chair.]

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